

3 OCT 1975

MEMORANDUM FOR: Deputy Director for Administration

SUBJECT : New Audit Staff Responsibilities

REFERENCES : (a) Memo For: Ch, Audit Staff from Director, CIA;  
dtd 4 Nov 74; Subj: Scope of Audits  
(b) Headquarters Regulations [REDACTED]

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1. The referenced memorandum from the Director and Headquarters Regulation [REDACTED] assign to the Audit Staff expanded responsibilities in reviewing and appraising Agency activities. These additional responsibilities are based on Federal Audit Policy issued by the General Services Administration (Tab A) and the Comptroller General's Standards for Audit (Tab B).

2. Neither the Director's memorandum nor the regulation spells out in any detail the specifics of these newly assigned responsibilities. We look, therefore, to the Comptroller General's Standards for Audit which sets forth three elements of an audit, the second of which is of primary concern to us at this time. It is defined as follows:

"(2) Economy and efficiency--determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures, or organizational structure."

The general objectives of the above category of audit work are as follows:

"2. A review of efficiency and economy shall include inquiry into whether, in carrying out its responsibilities, the audited entity is giving due consideration to conservation of its resources and minimum expenditure of effort. Examples of uneconomical practices or inefficiencies the auditor should be alert to include:

- a. Procedures, whether officially prescribed or merely followed, which are ineffective or more costly than justified.
- b. Duplication of effort by employees or between organizational units.
- c. Performance of work which serves little or no useful purpose.
- d. Inefficient or uneconomical use of equipment.
- e. Overstaffing in relation to work to be done.
- f. Faulty buying practices and accumulation of unneeded or excess quantities of property, materials, or supplies.
- g. Wasteful use of resources."

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3. A number of the above audit objectives, e.g., 2(b)(c) and (e) are similar and overlap those objectives traditionally contained in audits and surveys conducted by the Office of Personnel's Management and Compensation Division (PMCD). Historically, the PMCD audit and survey program has been the subject of periodic reviews by senior management of the Agency. In early 1971, for example, the Inspector General's Staff surveyed the Office of Personnel. (Tab C) One of their recommendations in the area of manpower utilization auditing prompted the Executive Director-Comptroller (Col. L.K. White) to request the Director of Personnel (H.B. Fisher) and the Director of Planning, Programing and Budgeting (C.A. Briggs) to consider their present responsibilities and submit to him specific recommendations as how current monitoring and auditing of manpower and personnel utilization could be improved. In response, the Director of Personnel and the D/PPB confirmed (Tab D) the need for an expanded PMCD staff to conduct manpower surveys in the course of which PMCD would aim to identify areas of ineffective organizations, work duplication and inappropriate utilization of personnel. As a result, [REDACTED] dated 7 January 1972 titled Position Survey Program (Tab E) was issued and established a three year position and manpower utilization survey schedule to be conducted by the Director of Personnel.

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4. Again in late October 1972, the Executive Director-Comptroller (W.E. Colby) requested (Tab F) that the Director of Personnel (H.B. Fisher) and the Inspector General (W.V. Broe) consider scheduling their respective surveys at the same time and report the results simultaneously in an effort to reach a fuller potential of effort expended and to reduce disruptions in the offices being surveyed. On review, the D/Pers and the IG stated (Tab G) that "the primary thrust of PMCD efforts is directed at organizational structure, position allocation and grade levels as matched against the missions and functions of the operating component, with a concern for the component's utilization of its allocated manpower within this particularized frame of reference. PMCD interviews with supervisors and working level personnel are designed to develop objective data that will serve the component's management in the decision making process." "The Inspector General's approach to surveys is a substantive one. The inspectors look at component programs and their implementation, judging whether a station is doing the things that it should do, or doing things it should not do, and how well it is doing what it does. There is an interest in the intensity of the effort expended and the work patterns of individuals. Consideration is also given to individual morale, employee needs, and inter-personal relationships. Obviously, all of this involves the IG team in testing the organizational arrangements of a station and the quality of its officers. This, in turn, may well call for a concentration on the matching of personal qualifications with tasks and work load. It is, therefore, inevitable that the IG team will see some of the same things that the PMCD team does and reach some of the same conclusions." They felt that "despite the similarity of objectives and,

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to some extent, the nature of the inquiries in the respective surveys, the nature of the findings and recommendations are sufficiently dissimilar to warrant the independent presentation and solution of issues as soon as possible."

5. Throughout the texts of the above examples of the top level management interest in the various aspects of PMCD activities runs the thread of recognition and confirmation of PMCD's role in identifying and reporting on many aspects of manpower utilization within the Agency including but not limited to some of those objectives stated in paragraph 2 above. In fulfilling their primary responsibilities in the job evaluation area, which requires in-depth knowledge of organizational structures and position content and inter-relationships, PMCD is in a "natural" position to carry out additional manpower utilization review responsibilities. PMCD's role in this area has long been established.

6. The apparent overlaps of responsibility and effort between the Audit Staff and the Office of Personnel are of obvious concern and presents us with a somewhat similar dilemma as we have had in the past with other "auditing" components, i.e., who will do what. We regret that we did not have an opportunity to study and comment on the references prior to their approval so that we could have a better understanding of their specifics. Nonetheless, we feel we need to sort out our respective responsibilities in the management review and appraisal areas to avoid duplication of effort and disruptions of component routines. We would appreciate an opportunity to explore this matter with you further.

[REDACTED]

F. W. M. Janney  
Director of Personnel

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4 November 1974

MEMORANDUM FOR: Chief, Audit Staff  
THROUGH: Inspector General  
SUBJECT: Scope of Audits

IG 74-044

1. Thank you very much for your proposal of "program audits" in CIA; together with your Report of Audit of OJCS as a specific example. I fully understand that this proposal reflects the Federal Audit Policy issued by the General Services Administration in FMC 73-2 and the Comptroller General's Standards for Audit. I understand at the same time that certain line managers have expressed concern over this widening of the scope of traditional audits in CIA. The General Services Administration has adopted these audit standards set forth by the Comptroller General; at the same time the special characteristics of CIA will require certain exceptions to the established procedures, as outlined in General Walters' letter of 26 March to GSA Administrator Sampson. This memorandum outlines my concept of the way we in CIA should approach the audit process.

2. Traditionally the CIA Audit Staff limited itself to financial and compliance audits. The Inspector General conducted organization inspections on a periodic basis. As a result of some question in my mind as to the end value and effect of those organizational inspections, the Inspector General's staff was reduced last year in conformance with personnel reductions and this inspection routine was suspended. At the time I contemplated its replacement by a combination of the annual Program Review pursuant to Management by Objectives procedures and a broadening audit function consistent with the Comptroller General's new standards. I believe this to be an adequate resolution of the competing demands of independent staff examinations of the management of our subordinate units, stringent financial audits of our activities, and detailed examinations of programs and performance of all our units on an annual basis. We need, however, an articulation of the inter-relationship of these three activities.

3. The Program Call and Annual Reports provided the primary vehicles for the annual appraisal of the needs and performance of subordinate units pursuant to Management by Objective procedures. The first priority task of the Audit Staff is to ensure that vigorous and regular financial audits are made of our activities. As a second task, the Audit Staff will conduct supplementary, independent program

audits of our operations pursuant to the audit standards established by the Comptroller General. Such audits will cover Agency-wide subject matter selected in coordination with the Comptroller, or directorate problems selected in coordination with the deputy director concerned. These program audits, additional to financial aspects, will be conducted with the cooperation of the Comptroller's office, the appropriate programs staffs of the directorates supervising the units audited, and in appropriate cases the Office of Personnel. In this fashion I believe the Audit Staff can also review program decision-making and performance through established mechanisms, focusing where possible on whether these mechanisms are functioning effectively. On these program audits, the Audit Staff will consult with the component under review, as has been customary in the past with its financial audits as well as with the Comptroller, prior to issuance of its report and findings. I expect the Audit Staff's independent judgment on the management aspects as well as the financial aspects of the audit, as required by the Comptroller General's audit standards. In carrying out program audits, it is expected that the Audit Staff will augment its regular financially-oriented personnel with individuals selected for their specific knowledge and background from a roster composed largely of CIA retirees.

4. The Inspector General will continue to inspect any situations in the Agency coming to his attention or suggested to him by others which in his view should be inspected and brought to my attention.

5. Following the submission of an audit by the Audit Staff to me, I will expect the Inspector General to ensure that a follow-up report of compliance or difference with the Audit Staff's conclusions will be made to me after an appropriate interval of time. Any substantial differences in view should be called to my attention for resolution with the deputy director concerned.

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6. Any exemption from audit for reasons of sensitivity of intelligence sources and methods will be subject to my approval after justification by the deputy director concerned.

  
W. E. Colby  
Director

cc: Deputy Director for Administration  
Deputy Director for Intelligence  
Deputy Director for Operations  
Deputy Director for Science and Technology  
Comptroller  
General Counsel  
Legislative Counsel

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**1. AUDIT OF AGENCY ACTIVITIES**

**a. POLICY.** The Agency will provide audit facilities and services to ensure a final and independent audit or audit review of components, installations, programs, and activities consistent with audit standards and requirements promulgated by authoritative audit and management offices of the Government, and with the guidelines set forth by the Director of Central Intelligence. Only the Director of Central Intelligence may exempt an Agency activity from audit.

**b. RESPONSIBILITIES**

- (1) The Audit Staff of the Office of the Inspector General is responsible for the examination and appraisal of policies, systems, procedures, records, and reports relating to programming, budgeting, accounting, procurement, and supply; and, other operations having an impact on the expenditure of funds, use of resources, or effective accomplishment of Agency objectives.
- (2) The Chief, Audit Staff will:
  - (a) Prepare an annual audit plan developed in coordination with program officials. The plan will cover all Agency activities subject to audit, the activities and locations selected for audit with assigned priorities, the reasons for their selection, the audit period, the scope of audit coverage, the management benefits anticipated from the audit, and evidence of coordination with the Comptroller or the appropriate Deputy Director on the selection of subject matter for management audits.
  - (b) Direct the performance of planned audits of headquarters components, domestic or overseas field installations, and related programs and projects. Dependent on the scope of audit coverage outlined in the audit plan, determine whether:
    - (1) Financial operations are properly conducted, financial reports are presented fairly, and compliance with laws and regulations has been achieved.
    - (2) Agency resources are managed and used in an economical and efficient manner.
    - (3) Desired results and objectives are being achieved in an effective manner.
  - (c) When an audit is planned which encompasses elements of subparagraph b(2)(b)(2) and/or (3) above, augment the audit team where necessary with an individual or individuals with appropriate experience in the technical field or operational area to be reviewed. These individuals may be drawn from either the Inspection Staff, the directorate involved, retirees, or outside consultants, and should be independent of the program under review. Individuals selected for augmentation of audit teams will be appropriately cleared with the Deputy Director concerned.
  - (d) Report the observations and recommendations resulting from audits to Agency officials responsible for taking actions, and to other responsible or management officials as may be appropriate.
  - (e) Follow up recommendations when necessary to assure that appropriate action is taken, and report to the Director of Central Intelligence through the Inspector General any recommendations that are not being resolved satisfactorily at operating levels.

→Revised: 3 June 1975 (882)

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(f) Determine the need for site audits of projects involving Agency instrumentalities [REDACTED] and engage or approve the public accountants to be used in those cases where cover or other reasons preclude the use of Agency auditors. Before instituting a site audit the Chief, Audit Staff will obtain:

(1) Concurrence on the use of either Agency auditors or public accountants from the office controlling the operational phases of the project, and from the offices having security, commercial, and cover responsibilities.

(2) Appropriate security clearances from the Office of Security if public accountants are to be employed.

(g) Direct the audit of all Agency-sponsored activities not funded by public appropriations, such as the Credit Union, the Employee Activity Association, the Voluntary Investment Plan, and employee health and insurance programs.

(3) Deputy Directors and Heads of Independent Offices are responsible for assuring that offices and personnel under their jurisdiction:

(a) Assist and cooperate with the Chief, Audit Staff and his representatives in carrying out their responsibilities.

(b) Reply to audit recommendations within 60 days.

(c) Obtain concurrent of Chief, Audit Staff before employing public accountants for audit purposes.

(d) Provide that all fees and expenses for audit services of public accountants will be paid by the project or activity audited.

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(e) Coordinate on the selection of subject matter for management audits.

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GENERAL SERVICES ADMINISTRATION  
OFFICE OF FEDERAL MANAGEMENT POLICY

***FEDERAL MANAGEMENT CIRCULAR***

FMC 73-2: Audit of Federal Operations and Programs  
by Executive Branch Agencies

September 27, 1973

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

1. Purpose. This circular sets forth policies to be followed in the audit of Federal operations and programs by executive departments and establishments.

2. Supersession. This circular supersedes Office of Management and Budget Circular No. A-73, dated August 4, 1965.

3. Policy intent. The primary objectives of this circular are to promote improved audit practices, to achieve more efficient use of manpower, to improve coordination of audit efforts, and to emphasize the need for early audits of new or substantially changed programs.

4. Applicability and scope. The provisions of this circular are applicable to all executive departments and establishments. The terms "agency" and "Federal agency" throughout this circular are synonymous with the term "departments and establishments" as defined in FMC 73-1.

5. Definitions.

a. The term "audit" as used in this circular means a systematic review or appraisal to determine and report on whether:

- (1) Financial operations are properly conducted;
- (2) Financial reports are presented fairly;
- (3) Applicable laws and regulations have been complied with;

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(4) and efficient manner; and

(5) Desired results and objectives are being achieved in an effective manner.

The above elements of an audit are most commonly referred to as financial/compliance (items 1, 2, and 3), economy/efficiency (item 4), and program results (item 5). Collectively, they represent the full scope of an audit and provide the greatest benefit to all potential users of Government audits. In developing audit plans, however, the audit scope should be tailored to each specific program according to the circumstances relating to the program, the management needs to be met, and the capacity of the audit facilities.

b. The term "audit standards" refers to those standards set forth in the Standards for Audit of Governmental Organizations, Programs, Activities & Functions issued by the Comptroller General of the United States.

6. Policies and procedures. Agencies are responsible for providing adequate audit coverage of their programs as a constructive aid in determining whether funds have been applied efficiently, economically, effectively, and in a manner that is consistent with related laws, program objectives, and underlying agreements. The audit standards will be the basic criteria on which audit coverage and operations are based. Agencies administering Federal grant, contract, and loan programs will encourage the appropriate application of these standards by non-Federal audit staffs involved in the audit of organizations administering Federal programs. Each agency will implement the policies set forth in this circular by issuing policies, plans, and procedures for the guidance of its auditors.

a. Organization and staffing. Audit services in Government are an integral part of the management process. Audit services and reports must be responsive to management needs. However, it is important in order to obtain the maximum benefit from this function that agency audit organizations have a sufficient degree of independence in carrying out their responsibilities. To provide an appropriate degree of independence, the audit organization should ordinarily be located outside the program management structure, report

to an agency management level sufficiently high to ensure proper consideration of and action on audit results, and be given reasonable latitude in selecting and carrying out assignments. Adequate and qualified staff should be assigned this important function. The audit of all programs under a single Federal department or agency must be coordinated, and where economies and a more effective audit service will result, especially in large and geographically dispersed programs, the audit operations within a department should be consolidated. It is also important to establish close coordination between audit and such other management review activities as may exist in an agency.

b. Determination of audit priorities. Each agency will establish procedures requiring periodic review of its individual programs and operations to determine the coverage, frequency, and priority of audit required for each. The review will include consideration of the following factors:

- (1) Newness, changed conditions, or sensitivity of the organization, program, activity, or function;
- (2) Its dollar magnitude and duration;
- (3) Extent of Federal participation either in terms of resources or regulatory authority;
- (4) Management needs to be met, as developed in consultation with the responsible program officials;
- (5) Prior audit experience, including the adequacy of the financial management system and controls;
- (6) Timeliness, reliability, and coverage of audit reports prepared by others, such as State and local governments and independent public accountants;
- (7) Results of other evaluations; e.g., inspections, program reviews, etc.;
- (8) Mandatory requirements of legislation or other congressional recommendations; and
- (9) Availability of audit resources.

c. Cross-servicing arrangements. To conserve manpower, promote efficiency, and minimize the impact of audits on the operations of the organizations subject to audit, each Federal agency will give full consideration to establishing cross-servicing arrangements under which one Federal agency will conduct audits for another--whenever such arrangements are in the best interest of the Federal Government and the organization being audited. This is particularly applicable in the Federal grant-in-aid and contract programs where two or more Federal agencies are frequently responsible for programs in the same organization or in offices located within the same geographical area. Under such circumstances, it will be the primary responsibility of the Federal agency with the predominant financial interest to take the initiative in collaborating with the other appropriate Federal agencies to determine the feasibility of one of the agencies' conducting audits for the others, and to work out mutually agreeable arrangements for carrying out the required audits on the most efficient basis.

d. Reliance on non-Federal audits. In developing audit plans, Federal agencies administering programs in partnership with organizations outside of the Federal Government will consider whether these organizations require periodic audits and whether the organizations have made or arranged for these audits. This consideration is especially necessary for those agencies that administer Federal grant-in-aid programs through State and local governments and which are subject to OMB Circular A-102, Attachment G. Attachment G provides standards for financial management systems of grant-supported activities of State and local governments and requires that such systems provide, at a minimum, for financial/compliance audits at least once every 2 years. Federal agencies will coordinate their audit requirements and approaches with these organizations to the maximum extent possible. The scope of individual Federal audits will give full recognition to the non-Federal audit effort. Reports prepared by non-Federal auditors will be used in lieu of Federal audits if the reports and supporting workpapers are available for review by the Federal agencies, if testing by Federal agencies indicates the audits are performed in accordance with generally accepted auditing standards (including the audit standards issued by the Comptroller General), and if the audits otherwise meet the requirements of the Federal agencies.

e. Audit plans. Based on the considerations set forth in b, c, and d, above, each agency will prepare an audit plan at least annually. At a minimum, such plans will reflect the:

(1) Audit universe (all programs and operations subject to audit);

(2) Programs and operations selected for audit, with priorities and specific reasons for selection;

(3) Audit organization that will conduct the audit;

(4) Audit cycle or frequency, the locations to be audited, and the reasons therefor;

(5) Scope of audit coverage to be provided and the reasons therefor; and

(6) Anticipated benefits to be obtained from the audits.

The plans should be adjusted as necessary to provide for audit coverage of unforeseen priorities.

f. Coordination of audit work. Federal agencies will coordinate and cooperate with each other in developing and carrying out their individual audit plans. Such actions will include continuous liaison; the exchange of audit techniques, objectives, and plans; and the development of audit schedules to minimize the amount of audit effort required. Federal agencies will encourage similar coordination and cooperation among Federal and non-Federal audit staffs where there is a common interest in the programs subject to audit.

g. Reports. Reporting standards are set forth in the Audit Standards for the guidance of Federal agencies. With respect to release of audit reports, each agency will establish policies regarding the release of audit reports outside the agency. Such policies will be in consonance with applicable laws, including the Freedom of Information Act, and, to the maximum extent possible, will provide for the dissemination of such reports in whole or in part to those interested in such information.

h. Agency action on audit reports. Each agency will provide policies for acting on audit recommendations. Timely action on recommendations by responsible management officials is an integral part of the effectiveness of an agency's audit system and has a direct bearing on it. Policies will provide for designating officials responsible for following up on audit recommendations, maintaining a record of the action taken on recommendations and time schedules for responding to and acting on audit recommendations, and submitting periodic reports to agency management on recommendations and action taken.

7. Responsibilities. Federal agencies will review the policies and practices currently followed in the audit of their operations and programs, and will initiate such action as is necessary to comply with the policies set forth in this circular. The head of each Federal agency will designate an official to serve as the agency representative on matters relating to the implementation of this circular. The name of the agency representative should be sent to the General Services Administration (AM), Washington, DC 20405, within 30 days after the receipt of this circular.

8. Reporting requirement. Each Federal agency will submit a report to the General Services Administration (AM), Washington, DC 20405, by December 31, 1973, on the action it has taken to implement the policies set forth in this circular. Specifically, the report will include actions taken on the issuance of policies, plans, and procedures for the guidance of its auditors; determination of audit priorities; new cross-servicing arrangements made; additional reliance on non-Federal audits; development of audit plans; and coordination of audit work between Federal agencies and between Federal and non-Federal audit staffs. Reports will be submitted at 6-month intervals on the additional actions taken until the circular is fully implemented. Copies of agency issuances on the implementation of this circular will be submitted to the Office of Federal Management Policy, General Services Administration, upon request.

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9. Inquiries. Further information concerning this circular  
may be obtained by contacting:

General Services Administration (AMF)  
Washington, DC 20405

Telephone: IDS 183-7747  
FTS 202-343-7747

A handwritten signature in cursive script, appearing to read "Sampson", with a long horizontal line extending from the end of the signature.

ARTHUR F. SAMPSON  
Administrator of General Services

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# **STANDARDS FOR AUDIT OF GOVERNMENTAL ORGANIZATIONS, PROGRAMS, ACTIVITIES & FUNCTIONS**

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BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

1972  
(1974 REPRINT)

Pamphlets explaining and supplementing the Standards have been issued as follows:

AUDIT STANDARDS SUPPLEMENT SERIES

- No. 1 What GAO Is Doing To Improve Governmental Auditing Standards
- No. 2 Auditors - Agents for Good Government
- No. 3 Case Study - Illinois' Use of Public Accountants For Auditing State Activities
- No. 4 Examples of Findings From Governmental Audits

Supplement No. 2, Auditors - Agents for Good Government, is for sale by the Superintendent of Documents, address below, price 25 cents. Stock Number 2000-00109.

Supplement No. 3, Case Study - Illinois' Use of Public Accountants For Audit-State Activities, is also for sale by the Superintendent of Documents.

Supplements Nos. 1 and 4 are available from the U.S. General Accounting Office, 441 G Street, N.W., Washington, D.C. 20548.

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For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402, price 65 cents. Stock Number 2000-00110

FOREWORD

In earlier and simpler times in our Nation's history, when the responsibilities of each level of government could be more clearly divided, each level could work fairly independently. Today, profound changes in our social, political, and economic order have brought steadily mounting demands for new and better public services in a variety and on a scale unprecedented in our history. Response to these demands requires a process of policymaking, financing, and administration which involves the cooperation of Federal, State, and local governments in solving public problems. Thus the Federal system of government today rests on an elaborate structure of interlocking relationships among all levels of government--between the executive and legislative branches of each, between the Federal and the State Governments, and between both and the local communities--for the conduct of programs designed to improve the quality of American life.

Accompanying this increased complexity in the relationship among the various levels of government has been an increased demand for information about government programs. Public officials, legislators, and the general public want to know whether governmental funds are handled properly and in compliance with existing laws and whether governmental programs are being conducted efficiently, effectively, and economically. They also want to have this information provided, or at least concurred in, by someone who is not an advocate of the program but is independent and objective.

This demand for information has widened the scope of governmental auditing so that such auditing no longer is a function concerned primarily with financial operations. Instead, governmental auditing now is also concerned with whether governmental organizations are achieving the purposes for which programs are authorized and funds are made available, are doing so economically and efficiently, and are complying with applicable laws and regulations. The standards contained in this statement were developed to apply to audits of this wider scope. These standards are intended to be applicable to all levels of government in the United States.

The survey and research work on which the accompanying statement is based was conducted by an interagency working group composed of representatives of the General Accounting Office and the Federal executive departments and agencies having the predominance of Federal grant programs. Assistance was also obtained from audit representatives of the State, county, and city governments visited during the course of the work and from leading professional organizations,

including the American Institute of Certified Public Accountants, the Institute of Internal Auditors, the Federal Government Accountants Association, the Municipal Finance Officers Association, and the American Accounting Association.

Consultative assistance was provided by university consultants; the Advisory Commission on Intergovernmental Relations; a consultant selected from one State, county, and city; and public interest groups generally representing State and local governments. Among the public interest groups participating were the Council of State Governments, the National Association of Counties, the National League of Cities, the United States Conference of Mayors, and the International City Management Association.

These standards were reviewed by a committee of the American Institute of Certified Public Accountants during 1973. The committee's report stated:

"The members of this Committee agree with the philosophy and objectives advocated by the GAO in its standards and believe that the GAO's broadened definition of auditing is a logical and worthwhile continuation of the evolution and growth of the auditing discipline."<sup>1</sup>

The General Accounting Office, on October 1, 1968, issued a statement entitled "Internal Auditing in Federal Agencies," which set forth the basic principles and concepts to be followed by Federal agencies in developing and operating their internal audit organizations. The purpose of that statement was to describe the role of the internal auditor in the Federal Government, the scope of his work, his proper location in the organizational structure, and related matters. A revision of that statement which incorporates these standards will be issued shortly.

These standards were originally published in June 1972. This reprint includes minor changes, none of which are considered to be of sufficient substance to merit explanatory comment. It is not intended that this reprint supersede the 1972 edition.

Comptroller General  
of the United States

January 15, 1974

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<sup>1</sup>"Auditing Standards Established by the GAO - Their Meaning and Significance for CPAs, A Report," American Institute of Certified Public Accountants, Committee on Relations with the General Accounting Office, New York, 1973, p. 12.

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PART I--INTRODUCTION

PURPOSE

This statement contains a body of audit standards that are intended for application to audits of all government organizations, programs, activities, and functions--whether they are performed by auditors employed by Federal, State, or local Governments; independent public accountants; or others qualified to perform parts of the audit work contemplated under these standards. These standards are also intended to apply to both internal audits and audits of contractors, grantees, and other external organizations performed by or for a governmental entity. These audit standards relate to the scope and quality of audit effort and to the characteristics of a professional and meaningful audit report.

The American Institute of Certified Public Accountants (AICPA) has adopted standards and procedures that are applicable to audits performed to express opinions on the fairness with which financial statements present the financial position and results of operations.<sup>1</sup> These standards are generally accepted for such audits and have been incorporated into this statement. However, the interests of many users of reports on Government audits are broader than those that can be satisfied by audits performed to establish the credibility of financial reports. To provide for audits that will fulfill these broader interests, the standards in this statement include the essence of those prescribed by the American Institute of Certified Public Accountants and additional standards for audits of a broader scope as will be explained subsequently.

SCOPE

A fundamental tenet of a democratic society holds that governments and agencies entrusted with public resources and the authority for applying them have a responsibility to render a full accounting of their activities. This accountability is inherent in the governmental process and is not always specifically identified by legislative provision. This governmental accountability should identify not only

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<sup>1</sup>The basic standards are included in "Statements on Auditing Procedure No. 33," issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants.

the objects for which the public resources have been devoted but also the manner and effect of their application.

This concept of accountability is woven into the basic premises supporting these standards. These standards provide for a scope of audit that includes not only financial and compliance auditing but also auditing for economy, efficiency, and achievement of desired results. Provision for such a scope of audit is not intended to imply that all audits are presently being conducted this way or that such an extensive scope is always desirable. However, an audit that would include provision for the interests of all potential users of government audits would ordinarily include provision for auditing all the above elements of the accountability of the responsible officials.

Definitions of the three elements of such an audit follow.

1. Financial and compliance--determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations.
2. Economy and efficiency--determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures, or organizational structure.
3. Program results--determines whether the desired results or benefits are being achieved, whether the objectives established by the legislature or other authorizing body are being met, and whether the agency has considered alternatives which might yield desired results at a lower cost.

The audit standards are intended to be more than the mere codification of current practices, tailored to existing audit capabilities. Purposely forward-looking, these standards include some concepts and areas of audit coverage which are still evolving in practice but which are vital to the accountability objectives sought in the audit of governments and of intergovernmental programs. Therefore the audit standards have been structured so that each of the three elements of audit can be performed separately if this is deemed desirable.

It should be recognized that a concurrent audit of all three parts would probably be the most economical manner of audit, but often this may not be practical. Furthermore, it may not be practical or necessary to perform all three elements of the audit in particular circumstances. For most government programs or activities, however, the interests of many potential government users will not be satisfied unless all three elements are performed.

In memorandums of engagements between governments and independent public accountants or other audit organizations, the arrangements should specifically identify whether all, or specifically which, of the three elements of the audit are to be conducted. Such agreements are needed to ensure that the scope of audit to be made is understood by all concerned.

#### BASIC PREMISES

The following certain basic premises underlie these standards and were considered in their development.

1. The term "audit" is used to describe not only work done by accountants in examining financial reports but also work done in reviewing (a) compliance with applicable laws and regulations, (b) efficiency and economy of operations, and (c) effectiveness in achieving program results.
2. Public office carries with it the responsibility to apply resources in an efficient, economical, and effective manner to achieve the purposes for which the resources were furnished. This responsibility applies to all resources, whether entrusted to the public officials by their own constituency or by other levels of government.
3. A public official is accountable to those who provide the resources he uses to carry out governmental programs. He is accountable both to other levels of government for the resources such levels have provided and to the electorate, the ultimate source of all governmental funds. Consequently he should be providing appropriate reports to those to whom he is accountable. Unless legal restrictions or other valid reasons prevent him from doing so, the auditor should make the results of audits available to other



levels of government that have supplied resources and to the electorate.

4. Auditing is an important part of the accountability process since it provides independent judgments of the credibility of public officials' statements about the manner in which they have carried out their responsibilities. Auditing also can help decisionmakers improve the efficiency, economy, and effectiveness of governmental operations by identifying where improvements are needed.
5. The interests of individual governments in many financially assisted programs often cannot be isolated because the resources applied have been commingled. Different levels of government share common interests in many programs. Therefore an audit should be designed to satisfy both the common and discrete accountability interests of each contributing government.
6. Cooperation by Federal, State, and local governments in auditing programs of common interest with a minimum of duplication is of mutual benefit to all concerned and is a practical method of auditing intergovernmental operations.
7. Auditors may rely upon the work of auditors at other levels of government if they satisfy themselves as to the other auditors' capabilities by appropriate tests of their work or by other acceptable methods.

An inherent assumption that underlies all the standards is that governments will cooperate in making audits in which they have mutual interests. For many programs that are federally assisted, it would be neither practical nor economical to have every auditor at every level of government do his own background research on the laws, regulations, objectives, and goals of his segment of the program. Therefore, to provide the auditor with the necessary background information and to guide his judgment in the application of the accompanying standards, Federal or State agencies that request State, local, or other levels to make audits are expected to prepare broad, comprehensive audit instructions, tailored to particular programs or program areas.

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The content of such audit guidance should include a digest of, or as a minimum, citations to applicable statutes, regulations, instructions, manuals, grant agreements, and other program documents; identification of specific audit objectives and reporting requirements in terms of matters of primary interest in such areas as program compliance, economy, and effectiveness; and other audit guidelines covering specific areas in which the auditor is expected to perform.

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PART II--SUMMARY

Part II is a summary of the standards. Parts III, IV, and V explain the standards more fully.

PART III--GENERAL STANDARDS

1. The full scope of an audit of a governmental program, function, activity, or organization should encompass:
  - a. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
  - b. A review of efficiency and economy in the use of resources.
  - c. A review to determine whether desired results are effectively achieved.

In determining the scope for a particular audit, responsible officials should give consideration to the needs of the potential users of the results of that audit.

2. The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.
3. In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.
4. Due professional care is to be used in conducting the audit and in preparing related reports.

PART IV--EXAMINATION AND EVALUATION STANDARDS

1. Work is to be adequately planned.
2. Assistants are to be properly supervised.

3. A review is to be made of compliance with legal and regulatory requirements.
4. An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance with laws and regulations, and to provide for efficient and effective operations.
5. Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations.

PART V--REPORTING STANDARDS

1. Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Unless restricted by law or regulation, copies should also be made available for public inspection.
2. Reports are to be issued on or before the dates specified by law, regulation, or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.
3. Each report shall:
  - a. Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
  - b. Present factual matter accurately, completely, and fairly.
  - c. Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.

- d. Include only factual information, findings, and conclusions that are adequately supported by enough evidence in the auditor's working papers to demonstrate or prove, when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.
- e. Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
- f. Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in balanced perspective, recognizing any unusual difficulties or circumstances faced by the operating officials concerned.
- g. Identify and explain issues and questions needing further study and consideration by the auditor or others.
- h. Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
- i. Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.

- j. Clearly explain the scope and objectives of the audit.
  - k. State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.
4. Each audit report containing financial reports shall:
- a. Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with other specified accounting principles applicable to the organization, program, function, or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
  - b. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of non-compliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.

PART III--GENERAL STANDARDS

CHAPTER 1

SCOPE OF AUDIT WORK

The first general standard for governmental auditing is:

The full scope of an audit of a governmental program, function, activity, or organization should encompass:

1. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
2. A review of efficiency and economy in the use of resources.
3. A review to determine whether desired results are effectively achieved.

In determining the scope for a particular audit, responsible officials should give consideration to the needs of the potential users of the results of the audit.

This standard places on officials who authorize and prescribe the scope of governmental audits the responsibility for providing for audit work that is broad enough to fulfill the needs of all potential users of the results of such audits. The standard is not intended to prevent such officials from authorizing specific assignments of parts of the total scope of the audit work required by the standard or from authorizing special audits, nor is it intended to prevent auditors from performing such audits. However, those responsible for authorizing governmental audits are charged with the knowledge that, for most governmental programs, their full responsibility for obtaining audit work is not discharged unless the full scope of audit work set forth in the standard is performed.

The general objectives of the above categories of audit work are as follows:

1. Examinations of financial transactions, accounts, and reports and compliance with applicable laws and regulations shall include sufficient audit work to determine whether:
  - a. The audited entity is maintaining effective control over revenues, expenditures, assets, and liabilities.
  - b. The audited entity is properly accounting for resources, liabilities, and operations.
  - c. The financial reports contain accurate, reliable, and useful financial data and are fairly presented.
  - d. The entity is complying with the requirements of applicable laws and regulations.
2. A review of efficiency and economy shall include inquiry into whether, in carrying out its responsibilities, the audited entity is giving due consideration to conservation of its resources and minimum expenditure of effort. Examples of uneconomical practices or inefficiencies the auditor should be alert to include:
  - a. Procedures, whether officially prescribed or merely followed, which are ineffective or more costly than justified.
  - b. Duplication of effort by employees or between organizational units.
  - c. Performance of work which serves little or no useful purpose.
  - d. Inefficient or uneconomical use of equipment.
  - e. Overstaffing in relation to work to be done.
  - f. Faulty buying practices and accumulation of unneeded or excess quantities of property, materials, or supplies.



g. Wasteful use of resources.

Efficiency and economy are both relative terms and it is virtually impossible to give an opinion as to whether an organization has reached the maximum practicable level of either. Therefore it is not contemplated in these standards that the auditor will be called upon to give such an opinion.

3. A review of the results of programs or activities shall include inquiry into the results or benefits achieved and whether the programs or activities are meeting established objectives. The auditor should consider:
  - a. The relevance and validity of the criteria used by the audited entity to judge effectiveness in achieving program results.
  - b. The appropriateness of the methods followed by the entity to evaluate effectiveness in achieving program results.
  - c. The accuracy of the data accumulated.
  - d. The reliability of the results obtained.

In some cases an auditor may be asked to participate in a program evaluation effort by accumulating data himself for evaluation of a program or activity under audit. When such work is to be done on a coordinated basis, the evaluation techniques should be uniformly prescribed for the whole program at some central level. The auditors at the various program sites should only be required to accumulate data and compare it with the prescribed measures. To do otherwise would be economically unfeasible and would lead to wide variations in the measurements applied to similar projects by different auditors.

## CHAPTER 2

### QUALIFICATIONS

The second general standard for governmental auditing is:

The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.

This standard places upon the auditor the responsibility for ensuring that the audit is conducted by personnel who collectively have the skills necessary for the type of audit that is to be performed.

The qualifications of the staff assigned to the audit should be commensurate with the scope and complexities of their audit assignments. Audits vary in purpose and scope. Some require an opinion on financial statements and the evaluation of compliance with specific laws and other requirements; others require reviews of efficiency and economy or effectiveness in achieving program results; still others require some or all of these three elements of audit work. Performing all three elements of audit work, in some cases, will require a wide variety of skills. The need for diverse skills may require cooperative audits by different audit organizations whose personnel collectively have the required capabilities.

Because there are variations in program objectives and organizational forms, as well as differences in laws, rules, and regulations applicable to such programs, the qualifications mentioned herein should apply to the skills of the audit organization as a whole and not necessarily to individual auditors. Thus, if an organization possesses personnel or consultants with acceptable skills in accounting, statistics, law, engineering, actuarial science, and related skills, each individual member of the organization need not himself possess all of these skills.

Requirements for staffs performing government audits are:

1. A basic knowledge of auditing theory and procedures and the education, ability, and experience to apply

such knowledge to the type of auditing work required for the task at hand.

2. A basic knowledge of governmental organization and operation. This knowledge may be acquired by appropriate education, study, or experience.
3. Skills appropriate for the work required in the audit. For auditing financial reports which lead to an opinion, the auditor must be proficient in accounting. Language setting forth the qualifications for independent public accountants who wish to perform such work is included in appendix I. For other types of auditing work, the skills of the auditors must be appropriate for the work to be done. For instance:
  - a. If the work requires use of statistical techniques, the audit staff must include persons having the appropriate statistical skills. These skills may be possessed by staff members or by consultants to the staff.
  - b. If the work requires extensive review of computerized systems, the audit staff must include persons having the appropriate computer skills. These skills may be possessed by staff members or by consultants to the staff.
  - c. If the work involves review into complex engineering data, the audit staff must include persons having the appropriate engineering skills. These skills may be possessed by staff members or by consultants to the staff.

### CHAPTER 3

#### INDEPENDENCE

The third general standard for governmental auditing is:

In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.

This standard places upon the auditor and the audit organization the responsibility for maintaining sufficient independence so that their opinions, conclusions, judgments, and recommendations will be impartial. If the auditor is not sufficiently independent to produce unbiased opinions, conclusions, and judgments, he should state in a prominent place in the audit report his relationship with the organization or officials being audited.<sup>1</sup>

The auditor should consider not only whether his own attitudes and beliefs permit him to be independent but also whether there is anything about his situation which would lead others to question his independence. Both situations deserve consideration since it is important not only that the auditor be, in fact, independent and impartial but also that other persons will consider him so.

There are three general classes of impairments that the auditor needs to consider; these are personal, external, and organizational impairments. If one or more of these are of such significance as to affect his ability to perform his work and report its results impartially, he should decline to perform the audit or indicate in his report that he was not fully independent.

#### PERSONAL IMPAIRMENTS

There are some circumstances in which an auditor cannot be impartial because of his views or his personal situation. These circumstances might include:

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<sup>1</sup>If the auditor is not fully independent because he is an employee of the audited entity, it will be adequate disclosure to so indicate. If the auditor is a practicing certified public accountant, his conduct should be governed by the AICPA "Statements on Auditing Procedure."

1. Relationships of an official, professional, and/or personal nature that might cause the auditor to limit the extent or character of his inquiry, to limit disclosure, or to weaken his findings in any way.
2. Preconceived ideas about the objectives or quality of a particular operation or personal likes or dislikes of individuals, groups, or objectives of a particular program.
3. Previous involvement in a decisionmaking or management capacity in the operations of the governmental entity or program being audited.
4. Biases and prejudices, including those induced by political or social convictions, which result from employment in or loyalty to a particular group, entity, or level of government.
5. Actual or potential restrictive influence when the auditor performs preaudit work and subsequently performs a post audit.
6. Financial interest, direct or indirect, in an organization or facility which is benefiting from the audited programs.

#### EXTERNAL IMPAIRMENTS

External factors can restrict the audit or impinge on the auditor's ability to form independent and objective opinions and conclusions. For example, under the following conditions either the audit itself could be adversely affected or the auditor would not have complete freedom to make an independent judgment.<sup>1</sup>

1. Interference or other influence that improperly or imprudently eliminates, restricts, or modifies the scope or character of the audit.

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<sup>1</sup>Some of these situations may constitute justifiable limitations on the scope of the work. In such cases the limitation should be identified in the auditor's report.

2. Interference with the selection or application of audit procedures or the selection of activities to be examined.
3. Denial of access to such sources of information as books, records, and supporting documents or denial of opportunity to obtain explanations by officials and employees of the governmental organization, program, or activity under audit.
4. Interference in the assignment of personnel to the audit task.
5. Retaliatory restrictions placed on funds or other resources dedicated to the audit operation.
6. Activity to overrule or significantly influence the auditor's judgment as to the appropriate content of the audit report.
7. Influences that place the auditor's continued employment in jeopardy for reasons other than competency or the need for audit services.
8. Unreasonable restrictions on the time allowed to competently complete an audit assignment.

#### ORGANIZATIONAL IMPAIRMENTS

The auditor's independence can be affected by his place within the organizational structure of governments. Auditors employed by Federal, State, or local government units may be subject to policy direction from superiors who are involved either directly or indirectly in the government management process. To achieve maximum independence, such auditors and the audit organization itself not only should report to the highest practicable echelon within their government but should be organizationally located outside the line-management function of the entity under audit.

These auditors should also be sufficiently removed from political pressures to ensure that they can conduct their auditing objectively and can report their conclusions completely without fear of censure. Whenever feasible they

should be under a system which will place decisions on compensation, training, job tenure, and advancement on a merit basis.

When independent public accountants or other independent professionals are engaged to perform work that includes inquiries into compliance with applicable laws and regulations, efficiency and economy of operations, or achievement of program results, they should be engaged by someone other than the officials responsible for the direction of the effort being audited. This practice removes the pressures that may result if the auditor must criticize the performance of those who engaged him. To remove this obstacle to independence, governments should arrange to have such auditors engaged by officials not directly involved in operations to be audited.

#### CHAPTER 4

##### DUE PROFESSIONAL CARE

The fourth general standard for governmental auditing is:

Due professional care is to be used in conducting the audit and in preparing related reports.

This standard places upon the auditor and the audit organization the responsibility for employing high professional standards in performing the work required in making examinations of governmental entities.

This standard does not imply unlimited responsibility for disclosure of irregularities or noncompliance; neither does it imply infallibility on the part of either the audit organization or the individual auditor. The standard does require professional performance of a quality appropriate for the complexities of the audit assignment undertaken.

The standard imposes upon the auditor a requirement to be alert for situations or transactions that could be indicative of fraud, improper or illegal expenditures or operations, inefficiency, waste, or lack of effectiveness. It does not, however, require that the auditor give absolute assurance that no material impropriety exists; nor does it require that a detailed audit of all transactions normally be undertaken.

The audit process should not be considered as a substitute for internal control. It is management's responsibility to institute adequate procedures and controls to prevent irregularities and improprieties and to encourage adherence to adopted policies and prescribed requirements. Auditing is primarily a test of these procedures and controls and is not a substitute for them.

Exercising due professional care means using good judgment in the choice of tests and procedures and doing a good job in applying them and in preparing reports. As a minimum the choice of tests and procedures requires consideration of:

1. What is necessary to achieve the audit objectives.



2. Relative materiality or importance of matters to which the procedures will be applied.
3. Effectiveness of internal controls.
4. Cost of the work being performed in relation to the benefits to be derived.

The quality of audit work and related reports depends upon the degree to which:

1. Tests and procedures are properly applied by competent persons.
2. Findings and conclusions are based on an objective evaluation of all pertinent facts.
3. Factual statements and conclusions contained in reports are fully supported by information obtained or developed during the audit.
4. The audit process conforms with the examination and evaluation standards prescribed in part IV and the reporting standards prescribed in part V.
5. A critical review is performed at every level of supervision of the work done and of the judgment exercised by those assisting in the examination.

Due professional care also includes obtaining a mutual understanding of the audit scope and objectives with the audited entity and those authorizing the audit if different from the entity. It also includes obtaining a good working understanding of the operations to be audited and any available underlying criteria of performance (including pertinent laws and regulations) to be utilized for evaluation purposes. When the established criteria for performance are vague, the auditor should attempt to obtain authoritative interpretation of the criteria. If the auditor is required to select measurement criteria, he should strive to reach agreement on the appropriateness of these measures with the interested parties.

Due professional care also includes followup work on findings resulting from similar audits made previously to determine whether appropriate corrective measures have been taken.

PART IV--EXAMINATION AND EVALUATION STANDARDS

CHAPTER 1

PLANNING

The first examination and evaluation standard for governmental auditing is:

Work is to be adequately planned.

This standard places upon the auditor or audit organization the responsibility for performing sufficient advance planning to provide a basis for an effective audit. The auditor should see that necessary or desired work steps are systematically laid out so that they can be understood by all levels in the audit structure, which will minimize the expenditure of staff time and resources on unnecessary work.

Planning in intergovernmental auditing is especially important because, in many instances, the audit work performed at one level of government should be correlated with work performed at other levels of government, all or some of which may have an interest in, or a statutory requirement to review, the discharge of financial, management, or program accountability of a single organization, function, activity, or program. When such correlation is necessary, it is essential that planning be done by some central agency which will set the objectives of the work so that the scope of the participatory audits done at individual program sites will be comparable and the results can be consolidated.

Where the required work includes reviews into the efficiency, economy, or achievement of desired results, adequate planning is especially important because the procedures employed in such audits are more varied and complex and, thus, more care is needed to select the appropriate procedures for the case at hand. Finally, planning is important to ensure that the results of the audit will satisfy the objectives of the audit.

Adequate planning should include planning for:

1. Coordination with other governmental auditors, when appropriate.

2. Personnel to be used on the assignment.
3. Work to be performed.
4. The format and general content of the report to be issued.

#### COORDINATION

In governmental auditing there frequently is a need for participatory audit work by groups of auditors at different locations who often are associated with an entity other than the one directing the auditors planning the audit work. This situation frequently involves audits of Federal grants under which the grantee is required to have audits made and to provide reports on such audits to the grantor. The situation also arises when a central audit agency having several field offices makes an audit of a program or activity that is being carried out at various locations and uses its field offices to make the audits at specific locations. Very careful planning by the central agency directing the audit is necessary if such audits are to be performed effectively and economically.

Planning for such coordinated audits must be tailored to the specific objectives of the audit. Ordinarily the central agency should specify such things as the laws and regulations that are to be considered by the auditor in reviewing compliance; the goals, objectives, and criteria of the program that are to be used in the review of program results; and the particular aspects of economy and efficiency that are to be considered in that part of the audit. Unless such planning is carefully performed and communicated to the participating audit staffs, the results of the audit are likely to be below the needs and expectations of the central agency. Unplanned audit effort also will offer difficult problems in comparing or consolidating the results of audits from various locations.

Furthermore, much of the planning necessary for a coordinated audit can only be done efficiently and economically at the central-agency level. Researching the laws and regulations applicable to a program and presenting clear, concise audit objectives is challenging and time-consuming work. To leave such work to each participating audit staff would result in excessive duplication and hence unacceptable additional cost. Moreover, some audits in which part of a transaction must be audited at one location and part at

another require even closer coordination if more than one audit staff does the work. The preparation of detailed guides for such audits is an integral part of the standard that audits should be properly planned.<sup>1</sup>

#### MULTIPLE-USE AUDITS

In some cases audits of the same organizations, programs, activities, or functions may be required by Federal law or regulation, State law or regulation, and/or municipal ordinances. Whenever practicable, planning for such audits should include planning for the requirements of all levels of government with the objective of making one audit serve the needs of all interested governmental levels.

#### PERSONNEL

Planning for use of personnel should include:

1. Assigning qualified staff having education and experience commensurate with the nature of the audit work required to be performed.
2. Efficiently employing the staff, including the assignment of a sufficient number of experienced workers and appropriate numbers and levels of supervisors. The planning should also include securing the services of outside consultants when necessary.
3. Providing appropriate on-the-job training for inexperienced personnel.

#### WORK TO BE PERFORMED

A written audit program should be prepared for each audit to provide for effective communication of the objectives of the audit to all staff members, to facilitate control of the audit work during the review phase, and to provide a permanent record of the audit plan. The information needed

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<sup>1</sup> A publication issued in 1972 by the American Institute of Certified Public Accountants provides guidance for use in preparation of audit guides. The publication is entitled "Suggested Guidelines for the Structure and Content of Audit Guides Prepared by Federal Agencies For Use by CPA's."

by the auditor to prepare a satisfactory audit program should vary with the types of audit and the entities to be audited; however, in most cases it is advisable to precede the preparation of the audit program with a survey of the entity to be audited to obtain basic working information about its operations and practices.

A skillfully performed survey should provide information about the size and scope of the entity's activities and any areas in which there may be weaknesses in internal controls, uneconomical or inefficient operations, lack of effectiveness in achieving prescribed goals, or lack of compliance with applicable laws and regulations. However, tests to determine the significance of such matters are to be performed in the detailed audit work and should be carefully set out in the audit program.

The audit program should ordinarily provide such information as:

1. Purpose and scope--The purpose of the audit and its scope should be described, and information should be provided as to whether the work is to include one or more of the three elements of an audit--financial and compliance, economy and efficiency, or program results.
2. Background--Information should be provided about the legal authority for the existence and operation of the organization, program, function, or activity to be audited, its sources of revenue, principal locations, and similar items needed to understand the objectives and operational characteristics of its work.
3. Definition of terms--Definitions and explanations should be included for any unique terms or abbreviations used by the audited organization, program, activity, or function.
4. Objectives of the audit--A carefully drawn statement of what the auditor is expected to produce as a result of his audit should be provided. This statement should be clearly expressed--ambiguous words should be carefully avoided--so that the auditor knows on what issues he is expected to reach conclusions. In financial and compliance audits, the

financial reports to be examined should be specified and the principal laws and regulations to which compliance is to be determined should be specified. In audits of program results, the criteria prescribed for evaluating the effectiveness of the program should be clearly set out.

5. Procedures--For many audits it is desirable to prescribe procedures for the auditor to follow in achieving the audit objectives. When multilocation programs involving program effectiveness are to be performed at a number of locations, the audit organization planning the work centrally should ordinarily prescribe very specific methods to be followed in the examination to be sure that the data obtained from all participating locations will be comparable. However, this should be done in a manner that does not restrict the auditor's professional judgment. Audit programs should never be used as a blind checklist or in a way that stifles initiative, imagination, and thoroughness in performing an audit.
6. Report--The audit program should set forth the general format to be followed in the auditor's report and a general discussion of the type of information desired in it.

#### ACCESS TO WORKING PAPERS

Arrangements should be made to ensure that working papers will be made available upon request to other governmental audit staffs and auditors who follow at later dates. A provision relative to access of working papers should be written into all contractual arrangements for governmental audits.

CHAPTER 2

SUPERVISION

The second examination and evaluation standard for governmental auditing is:

Assistants are to be properly supervised.

This standard places upon the auditor or audit organization the responsibility for ensuring that less skilled staff members receive appropriate guidance in the performance of their work.

The most effective way to control the quality and to expedite the progress of an assignment is by exercising proper supervision from the start of the preparatory work to the completion of the report draft. Supervision adds seasoned judgment to the work performed by less experienced members of the staff and provides necessary training for such staff members.

The assignment and use of assistants is an important factor in achieving the established objectives in a satisfactory manner. Since training, experience, and other qualifications vary among auditors, specific work assignments must be commensurate with abilities.

Supervisors should see that assistants have a clear understanding of their assigned tasks before they start the work. Assistants should be informed not only of what work they are to do and the way they are to proceed but also of what the work is expected to accomplish. With a seasoned staff the supervisor's part may be more general in character. He may outline the broad course of the work and leave details to assistants. With a less experienced staff the supervisor may have to go into many of the details himself and instruct his staff specifically as to what they are to do and how they are to do it.

Supervisory review should be directed to both the substance and the method of auditing. The review should ensure that (1) conformance with audit standards is obtained, (2) the audit programs are followed, unless deviation is justified and authorized, (3) the working papers adequately support findings and conclusions, (4) the working papers

CHAPTER 3

LEGAL AND REGULATORY REQUIREMENTS

The third examination and evaluation standard for governmental auditing is:

A review is to be made of compliance with legal and regulatory requirements.

In governmental auditing, compliance with pertinent laws and regulations is particularly significant because government organizations, functions, programs, or activities are creatures of law and have more specific rules and regulations than are usually applicable to private organizations.

This standard places upon the auditor the responsibility for determining whether the organization, program, function, or activity under audit has complied with the requirements placed upon it by pertinent laws and regulations. In reviewing compliance with pertinent laws and regulations, the auditor should consider not only statutes and implementing regulations but also the related legislative history, legal opinions, court cases, and regulatory requirements, including such documents as grant or loan agreements.

When the auditor is at the central-agency level, he should ordinarily take the responsibility for determining the laws and regulations which should be considered in the audit. When grants from another level of government are involved, legal and regulatory requirements should ordinarily be obtained from that level and should be made available through audit guides to the grantee's auditor. To do otherwise would result in substantial duplicate work in cases in which there are two or more entities to be audited. Furthermore, the grantor is familiar with these statutes and requirements and can provide them and the related supporting data with far less effort than would be required by the grantee's auditor.

In making his review, the auditor at the central-agency level should select and review those laws and regulations which have a direct bearing or a significant impact upon the entity to be audited or its operations. The laws and regulations which may apply to a specific government



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provide adequate data to prepare a meaningful report, and  
(5) the auditor will accomplish the audit objectives. Documentation of supervisory reviews should be prepared and retained.

- b. Pertinent correspondence from grantors and grantees.
- c. Memorandums of meetings held to discuss the grants.
- d. The grant documents, including amendments.
- e. Grant regulations.
- f. Grant budgets and supporting schedules.

The nature and purpose of the review of legal and administrative requirements will tend to vary with the element of auditing being performed.

Financial and compliance--The auditor is to test the financial transactions and operations of the audited organization, program, function, or activity to determine whether that entity is in compliance with pertinent laws or regulations. The auditor also is to make a review to satisfy himself that the audited entity has not incurred significant unrecorded liabilities (contingent or actual) through failure to comply with, or through violation of, pertinent laws and regulations.

Economy and efficiency--The auditor is to make a review of the laws and regulations applying to any aspect of the audited organization, program, function, or activity in which he attempts to make a judgment regarding whether existing practices can be made significantly more efficient or economical. Such a review is needed because determinations of how the entity's tasks can be accomplished more efficiently and economically cannot be done properly without an understanding of the purpose of the entity and what it is legally required to do. Such a review is needed also to provide the auditor with information on constraints on the entity's authority to change its practices to make them more efficient and economical.

Program results--The auditor is to review the laws and regulations pertaining to the goals and objectives of the audited entity's programs or activities in sufficient depth to gain a working understanding of the results that are expected from the programs

organization, program, function, or activity are often very extensive, and the auditor cannot be expected to review every law or regulation which may in some way impact on the entity. Consequently, this type of review requires considerable judgment. As a general rule, the auditor first should find out from the audited entity's management the legal and regulatory requirements it is required to follow. He then should make his own tests to determine whether any requirements are being overlooked by the entity. Some sources of information on legal and regulatory requirements follow.

1. Legal or legislative data, including:
  - a. Basic legislation.
  - b. Reports of hearings.
  - c. Legislative committee reports.
  - d. Annotated references from reference services covering related court decisions and legal opinions.
  - e. Historical data relating to the movements to achieve the legislation and similar prior legislation.
  - f. State constitutions, statutes, resolutions, and legislative orders.
  - g. Local charters, ordinances, and resolutions.
2. External administrative requirements, including:
  - a. Memorandums from Federal, State, or local administrative agencies.
  - b. Guidelines and other administrative regulations affecting program operations from Federal, State, or local agencies.
3. Grant arrangements, when grants are involved, including:
  - a. Proposals from grantees.

CHAPTER 4

INTERNAL CONTROL

The fourth examination and evaluation standard for governmental auditing is:

An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance with laws and regulations, and to provide for efficient and effective operations.

This standard places upon the auditor the responsibility for determining how much reliance he can place on the audited entity's internal controls to ensure accurate information, ensure compliance with applicable laws and regulations, promote efficiency and economy, and produce effective results. His findings will help him determine the extent of detailed examination work he must perform to achieve the objectives of the audit.

Internal control comprises the plan of organization and all the coordinate methods and measures adopted to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. The term embraces the policies, procedures, and practices established or encouraged by management as well as the plan of organization and other measures intended to carry them out.

The characteristics of a satisfactory system of internal control would include:

1. A plan of organization that provides segregation of duties appropriate for proper safeguarding of the entity's resources.
2. A system of authorization and record procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenses.
3. An established system of practices to be followed in performance of duties and functions of each of the organizational departments.

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or activities. He must also do sufficient testing to determine whether the programs or activities are being performed in conformity with applicable laws and regulations.

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4. Personnel of a quality commensurate with their responsibilities.
5. An effective system of internal review.

These elements, as important as each is in its own right, are mutually reinforcing and all are so basic to adequate internal control that serious deficiencies in any one normally would preclude effective operation of the system.

A complete review of internal controls as a specific requirement would often be prohibitive in terms of available resources. Examining all such controls would not be efficient auditing because of the irrelevance of some controls to the basic issues which are the subject of the audit effort. Therefore the auditor should concentrate his attention on those controls which are important to the issues being audited.

The extent of work required to adequately review internal control will vary with the element of an audit being performed.

Financial and compliance--A sufficient review is to be made of internal controls to permit the auditor to determine how much reliance he can place upon the accounting records and reports to accurately portray the financial condition of the organization, program, function, or activity and to safeguard its resources. The extent of his own tests of the accounting data should be based upon his assessment of the reliability of the audited entity's internal control. The review should be sufficient to permit the auditor to determine whether policies, procedures, and practices are consistent with the applicable laws and regulations and whether the system of internal control can be relied upon to provide reasonable assurance that such policies and practices are being followed.

Efficiency and economy--The review is to include a review of policies, procedures, practices, and internal controls applicable to any aspect of the activities in which the auditor attempts to make a judgment regarding whether existing practices can be made significantly more efficient or economical.

Program results--The auditor is to review those policies, procedures, practices, and controls which have a specific bearing on the attainment of the goals and objectives specified by the law or regulations that created the program, activity, function, or organization under audit.

Internal review is an important part of internal control and the auditor should look into such work in performing any of the three audit elements listed above. The auditor should consider the extent of the internal review work and the extent to which that work can be relied upon to ensure that other aspects of internal control are functioning properly. The auditor should take full advantage of the products of the internal review in making his audit.

In view of the wide range in the size, variety, and nature of governmental organizations, programs, activities, and functions, and in view of their organizational concepts and operating methods, no single pattern for internal review activities can be specified. Many governmental entities have internal review activities identified by other names, such as inspection, appraisal, investigation, organization and methods, and management analysis. These activities are often in the nature of management services, and in varied ways they assist management in currently supervising, advising, and reviewing designated functions. To prevent duplication of effort, all auditors--regardless of their level of government--should use, to the maximum practical extent, the work that other auditors or internal review personnel have previously performed.

## CHAPTER 5

### EVIDENCE

The fifth examination and evaluation standard for governmental auditing is:

Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations.

This standard places upon the auditor the responsibility for accumulating sufficient evidence to provide an appropriate factual basis for his opinions, conclusions, judgments, and recommendations.

Evidence needed to support the auditor's findings may be (1) physical evidence obtained by observation, photograph, or similar means, (2) testimonial evidence obtained by interviewing or taking statements from involved persons, (3) documentary evidence consisting of letters, contracts, extracts from books of account, and so forth, and (4) analytical evidence secured by analysis of information the auditor has obtained.

Regardless of the type, the evidence involved should meet the basic tests of sufficiency, competence, and relevance. The auditor's working papers should reflect the details of the evidence he has relied upon and should disclose the procedures he has employed in obtaining it.

### SUFFICIENCY

Sufficiency is the presence of enough factual, adequate and convincing evidence to lead a prudent person to the same conclusion as the auditor. Determining the sufficiency of evidence requires judgment, because there frequently is conflicting evidence and the auditor must make an impartial judgment as to what position is supported by the weight of evidence. When appropriate, statistical methods may be employed to establish sufficiency.

There is no need for elaborate documentation to support noncontroversial or insignificant points. For significant matters, however, the auditor should gather sufficient evidence to show the factors he relied upon to reach his conclusion.



#### COMPETENCE

Competent evidence should be reliable and the best attainable through the use of reasonable audit methods. In evaluating the competence of evidence, the auditor should carefully consider whether there is any reason to doubt its validity or completeness. If there is reason for doubt, the auditor should take additional measures to authenticate the evidence.

The following presumptions are useful in judging the competence of evidence; however, these presumptions are not to be considered as sufficient in themselves to reach a conclusion.

1. Evidence obtained from an independent source provides greater assurance of reliability than that secured from the audit organization.
2. Evidence developed under a good system of internal control is more likely to be reliable than that obtained where such control is weak or unsatisfactory.
3. Evidence obtained by the auditor through physical examination, observation, computation, and inspection is more reliable than evidence obtained indirectly.
4. Original documents are more reliable than copies.

#### RELEVANCE

Relevance refers to the relationship of the information to its use. The facts and opinions used to prove or disprove an issue must have logical sensible relationship to that issue. Information which does not have this relationship is irrelevant and therefore should not be included as evidence to prove or disprove a point.

#### WORKING PAPERS

Working papers serve as the connecting link between the auditor's fieldwork and his report and, as such, should contain the evidence accumulated in support of the conclusions and recommendations included in the report. Auditors should adopt reasonable procedures to ensure the safe custody and retention of their working papers for a period of time sufficient to satisfy pertinent legal and administrative requirements.

General guidelines for the preparation of working papers follow.

1. Completeness and accuracy--Working papers should be complete and accurate in order to provide proper support for findings, conclusions, and recommendations and to enable demonstration of the nature and scope of examination work, when necessary.
2. Clarity and understandability--Working papers should be clear and understandable without supplementary oral explanations. The information they reveal should be clear and complete, but concise. Anyone using the working papers should be able to readily determine their purpose, the nature and scope of the work done, and the preparer's conclusions. Conciseness is important, but clarity and completeness should not be sacrificed just to save time or paper.
3. Legibility and neatness--Working papers should be legible and as neat as practicable. Otherwise time will be wasted in reviewing them and in preparing reports. Sloppy working papers may lose their worth as evidence. Crowding and writing between lines should be avoided by anticipating space needs and arranging the working papers before writing.
4. Pertinence--The information contained in working papers should be restricted to matters which are materially important, pertinent, and useful with reference to the objectives established for the assignment. There are no substitutes for a working understanding of the specific objectives of the audit, the reasons for performing a specific task, and their relation to approved objectives. This

knowledge comes from well-planned and well-organized work programs and effective instruction by supervisors. The practice of having all working papers contain clear statements of purpose is very helpful in ensuring that information accumulated is properly tied to audit objectives and reporting.

PART V--REPORTING STANDARDS

CHAPTER 1

FORM AND DISTRIBUTION

The first reporting standard for governmental auditing is:

Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Copies should also be made available for public inspection.

This standard provides that a written record of the results of each governmental audit be prepared. The standard is not intended to limit or prevent discussions of findings, judgments, conclusions, and recommendations with persons who have responsibilities involving the area being audited. On the contrary, such discussions should be encouraged. However, regardless of whether such discussions are held, a written report should be prepared.

There are a number of reasons why written reports are particularly necessary. Reports should be prepared in written form (1) so that the results can be widely communicated to responsible officials at all levels of government, (2) to make the auditor's findings and recommendations less susceptible to misunderstanding, (3) to make the auditor's findings available for public inspection, and (4) to facilitate subsequent followup work to determine whether appropriate measures have been taken in response to the auditor's findings and recommendations.

Distribution of audit reports should be to as many of the interested officials as practicable. In some cases the subject matter of the audit may involve material that is classified for security purposes or is not releasable for other valid reasons. As a general rule, however, the audit report should be distributed to those officials having a direct interest in the results of the auditor's work. Such officials include those designated by law or regulation to receive such reports; those responsible, either directly or in supervisory capacity, for taking action on the auditor's findings and recommendations; legislators; and those of other levels of government that have provided funds to the audited organization. Also, unless restricted by law or regulation, copies of audit reports should be made available for distribution to or inspection by interested members of the public.

When independent public accountants are engaged, it shall be the responsibility of the engaging organization to ensure that appropriate distribution is made to interested parties. If it is desired that the public accountants make the distribution of their report, arrangements for such distribution should be made a part of the engagement agreement indicating precisely what officials or organizations shall receive the report.

CHAPTER 2

TIMELINESS

The second reporting standard for governmental auditing is:

Reports are to be issued on or before the dates specified by law, regulation, or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.

To be of maximum use, the audit report must be as timely as possible. The auditor should realize that every day delayed in issuing his report diminishes its value; therefore he should plan and conduct his work with the objective of reporting the results of his work in the shortest feasible time.

The auditor should consider interim communication of significant matters to appropriate officials during the course of his audit work. Such communication is not a substitute for a final written report, but it does alert officials to matters needing correction at an earlier date and permits these officials to instigate corrective measures earlier than is possible if the auditor's findings and recommendations are withheld until his final report is completed.

CHAPTER 3

CONTENT

The third reporting standard for governmental auditing is:

All reports shall:

1. Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
2. Present factual matter accurately, completely, and fairly.
3. Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.
4. Include only factual information, findings, and conclusions that are adequately supported by enough evidence in the auditor's working papers to demonstrate or prove, when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.
5. Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
6. Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented

in balanced perspective of any unusual difficulties or circumstances faced by the operating officials concerned.

7. Identify and explain issues and questions needing further study and consideration by the auditor or others.
8. Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
9. Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.
10. Clearly explain the scope and objectives of the audit.
11. State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.

This standard places upon the auditor the responsibility for preparing a report that will be easy to understand, will present the scope of the audit and the auditor's findings and conclusions in an objective and complete manner with appropriate support for positions taken, and will



provide recommendations for improvement whenever feasible and appropriate.

#### CONCISENESS

The reports should be no longer than necessary to communicate the information the auditor is reporting. Reports should not be mired down with too much detail--words, sentences, paragraphs, or sections that do not clearly tie in with the report messages. Too much detail detracts from the reports, may even conceal the real messages and may confuse or discourage readers.

Although there is room for considerable judgment in determining the content of reports, it should be kept in mind that reports which are complete, but still concise, are more likely to receive attention.

#### ACCURACY, COMPLETENESS, AND FAIRNESS

Report preparation, review, and processing procedures should be applied to produce reports that contain no errors of fact, logic, or reasoning.

The need for accuracy is based on the need to be fair and impartial in reporting and to assure users and readers of reports that what is reported is reliable. One inaccuracy in a report can cast doubt on the validity of an entire report and can divert attention from the substance of the report.

Although reports should be concise, they should not be so concise that they do not fully inform the user. Reports should contain sufficient information about findings, conclusions, and recommendations to promote adequate understanding of the matters reported and to provide convincing, but fair, presentations in proper perspective. Sufficient amounts of background information should also be included.

Readers should not be expected to possess all the same facts that the auditor has, and therefore reports should not be written on the bases that the bare recitals of facts make the conclusions reached obvious or inescapable. If the auditor has conclusions or opinions that he wants the

readers to know about, he should state them specifically rather than leave them to be inferred by the readers.

#### OBJECTIVITY

Findings should be presented in an objective and unbiased manner and should include sufficient information on the subject matter to provide readers with proper perspective. The objective is to produce reports which are fair and not misleading and which, at the same time, place primary emphasis on matters needing attention. The auditor should guard against the tendency to exaggerate or over-emphasize deficient performance noted during his review.

The information needed to provide proper report balance and perspective should include:

1. Appropriate information as to why the examination was made.
2. Information about the size and nature of the activities or programs to which findings relate so as to provide perspective against which the significance of the findings can be judged.
3. Correct and fair descriptions of findings so as to avoid misinterpretation and misunderstanding. Information should be included on the size of tests and the methods of selecting items to test so that the readers may relate such information to the total activity and to the findings.

#### ADEQUATE SUPPORT

All factual data, findings, and conclusions in reports should be supported by enough objective evidence to demonstrate or prove the bases for the matters reported and their accuracy or reasonableness. Except as necessary to make convincing presentations, detailed supporting data need not be included in reports.

Opinions and conclusions in reports should be clearly identified as such and should be based on enough audit work to warrant them. In most cases one example of a deficiency cannot support a broad conclusion and a related recommendation for corrective action. All that it supports

is the finding of the fact that there was a deviation, error, or weakness.

#### RECOMMENDATIONS

The auditor's report should contain appropriate recommendations whenever his review discloses that significant improvement in the audited entity is possible. He should also make recommendations to effect compliance with legal or regulatory requirements when significant instances of non-compliance are noted.

If the auditor cannot make appropriate recommendations because of limited audit scope or other reasons, he should state in his report the reason that he is unable to recommend appropriate corrective measures and what additional work would need to be done to formulate recommendations.

#### CONSTRUCTIVENESS OF TONE

The tone of reports should be designed to encourage favorable reaction to findings and recommendations. The titles, captions, and texts of reports should be stated in constructive terms. Although findings should be presented in clear, forthright terms, the auditor should keep in mind that his objective is to obtain favorable reaction and that this can best be accomplished by avoiding language which unnecessarily generates defensiveness and opposition. Although criticism of past performance often is necessary to demonstrate the need for some management improvements, the emphasis in reports should be on the needed improvements rather than on criticism.

#### ISSUES NEEDING FURTHER STUDY

If the scope of the audit or other factors limits the auditor's ability to inquire into certain matters which he believes should be studied, the auditor should include in his report such matters, if of sufficient importance, and the reasons why he believes these matters merit further study.

#### RECOGNITION OF NOTEWORTHY ACCOMPLISHMENTS

Information as to the satisfactory aspects, not just the deficient aspects, of operations examined, when

significant and when warranted by the extent of the work, should be included in the auditor's report. Such information is often necessary to fairly present the situation which the auditor finds and to provide appropriate balance to his report. In addition, when such accomplishment may be emulated by others, the inclusion in the auditor's report may result in improved performance by other government organizations that read the report.

#### VIEWS OF RESPONSIBLE OFFICIALS

One of the most effective ways of ensuring that reports are fair, complete, and objective is through advance reviews and comments by persons or by officials of the organizations, programs, functions, or activities whose operations are discussed in the reports. This produces a report which shows not only what was found and what the auditor thinks about it but also what the responsible persons think about it and what, if anything, they are going to do about it. This kind of report is more useful to the recipient

Comments on report drafts should be objectively considered and evaluated, and the report presentations and conclusions should give appropriate recognition to them. The advance comments and analyses of them should be fairly presented in the text of reports. An agency promise of corrective action should be noted in proper context but should not be accepted as justification for dropping a significant point or a related recommendation.

When the advance comments oppose the auditor's findings or conclusions and are not, in his opinion, meritorious, the auditor should state his reasons for rejecting them. Conversely, he should drop a point or modify a position if he finds the argumentation to be meritorious.

#### SCOPE AND OBJECTIVES

The scope of the audit should be stated in all reports. Some audits are more limited in scope than others, e.g., those confined to specific functions, activities, or locations. Such limitations of scope should be clearly and explicitly identified. When successive audits vary in scope, the auditor should explain why particular work was or was not performed and also should use individually tailored language in the scope section of the report to

define the limited nature or special aspects considered in performing the audit. The time period covered in the audit should be indicated.

The scope of the audit should clearly indicate whether each of the three elements of audit examinations--financial and compliance, efficiency and economy, and program results--were made and the extent of each element.

The audit report should include a summary statement of the objectives of the audit as identified in the audit guide or engagement memorandum. This statement is essential to provide the reader with the proper perspective, i.e., a background against which any reported findings may be considered. Management may request special coverage; this too should be provided in the audit instructions.

PRIVILEGED AND CONFIDENTIAL INFORMATION

Certain financial or operating information is prohibited from general disclosure by management or by Federal, State, or local laws or regulations. Such information is usually provided only to persons authorized by law or regulation on a need-to-know basis.

If the auditor is prohibited by such requirements from including some pertinent data in his report, he should describe what has been omitted and the requirement that makes the omission necessary. The auditor should obtain assurance that a valid requirement for the omission exists and that the doctrine of privilege or confidentiality is not applied to information that would reflect unfavorably on management but for which there is no valid reason for withholding.

CHAPTER 4

FINANCIAL REPORTS

The fourth reporting standard for governmental auditing is:

Each audit report containing financial reports shall:

1. Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with other specified accounting principles applicable to the organization, program, function, or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
2. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of noncompliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.

This standard places upon the auditor the responsibility for informing the reader on the degree of responsibility the auditor assumes for the financial data presented and for providing appropriate explanatory comments on

significant financial issues affecting the reports and compliance with legal or other regulatory requirements.

#### OPINIONS ON FINANCIAL REPORTS

When financial reports of Federal departments, States, cities, counties, and other units of government and their programs, functions, or activities are being examined, the auditor should give his opinion as to whether the reports have been prepared in accordance with appropriate principles of accounting, applied on a basis consistent with that of the preceding period, and whether the auditor's examination was made in accordance with the accompanying auditing standards. Illustrative opinions are included in Federal audit guides and in pronouncements of the American Institute of Certified Public Accountants.<sup>1</sup> When conformity with special accounting principles is required instead of with generally accepted accounting principles, the special accounting principles followed by the audited organization, program, function, or activity should be specified in the opinion.

#### ACCOUNTING PRINCIPLES

Accounting principles are guides or rules developed from experience or from research. Their purpose is to provide assurance that the information presented in the financial statements is valid, useful, and reliable. The auditor should make sufficient examination into the accounting principles used to permit a professional opinion as to whether the accounting system and the representations of management evidenced by financial reports are in conformity with such principles. Material changes and the reasons for them, if ascertainable, should be identified and their effect upon the financial reports, both historically and prospectively, should be explained. The auditor should also state his opinion as to the propriety of the change. Accounting principles on which the auditor's opinion is based should be identified in his report, as should statutory or administrative provisions adversely affecting the accounting principles in use by the organization, program, or activity.

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<sup>1</sup> See "Statements on Auditing Procedure," particularly Statement 33.

CONSISTENCY

The auditor should state whether the entity under audit has consistently followed the same accounting principles from one reporting period to another. This standard applies not only to data shown in statements of financial condition and operating reports but also to budgetary or statistical data which may be covered by the auditor's report.

When a qualification is required because of a lack of consistency that is material to the financial report, the qualification statement should describe (1) the reasons for the qualification, (2) the effect upon the financial reports of the audited entity, and (3) the auditor's opinion of the acceptability of the change.

DISCLOSURE

A governmental entity's reports and statements, both financial and operational, ideally should contain the information necessary for users--management, the electorate, creditors, grantors, and others--to form an opinion on the effectiveness of the stewardship exercised by the responsible public officials. The responsibility for providing such information is that of management. However, the auditor should comment if the data provided is insufficient to disclose any matters which may have a material effect upon the financial reports.

Adequate disclosure does not imply or require that an excessive amount of information be furnished. Disclosure should, however, be fair and reasonably complete--but not so complex as to confuse or impede understanding. Information should be reduced to manageable and understandable proportions, yet it should avoid summarization to such an extent that needed background or relationships are omitted or blurred.

Weight should be given to materiality, which is the relative importance or relevance of an item included in or



omitted from a financial or operating report. There are no universal ratios or percentages that can be used as standards of materiality for financial or operational processes or transactions. Materiality should be based on judgment.

Six specific indicators of materiality which can be used individually or in combinations are:

1. Absolute dollar amount.
2. Ratio of amount of an item to an appropriate base figure.
3. Length of life of an asset.
4. Importance of the item to the accomplishment of the mission.
5. Importance to the maintenance of adequate controls, such as a pattern of small discrepancies.
6. The characteristic of the items involved, such as indications of malfeasance or misfeasance.

Events that occur subsequent to the end of the period under audit may have a material effect on the operations of the entity or on its operational or financial reports. Such events may affect financial reports directly, may affect the entity with indirect effects on financial reports, or may affect conditions under which the operations take place. If such events occur they should be disclosed in the audit report either by revision of the financial reports or by commentary in the auditor's report.

#### LEGAL OR REGULATORY REQUIREMENTS

In any governmental audit in which the auditor is expected to give an opinion on the fairness of the presentations in financial reports, compliance with applicable laws and regulatory requirements is a matter of importance because noncompliance might result in liabilities not disclosed in the financial reports. Compliance with laws and regulatory requirements, in many instances, assumes an even greater importance since the recipients of the financial reports and the audit reports also want to know whether funds designated for certain purposes were spent for those purposes.

The standards for examination and evaluation require consideration of applicable laws and regulations in the auditor's examination. The standards for reporting require a statement in his report regarding any significant instances of noncompliance disclosed by his examination and evaluation work. What is to be included in this statement requires judgment. Significant instances of noncompliance, even those not resulting in legal liability to the audited entity, should be included. Minor procedural noncompliance need not be disclosed.

Although the reporting standard is generally on an exception basis--that only noncompliance need be reported--it should be recognized that governmental entities often want positive statements regarding whether or not the auditor's tests disclosed instances of noncompliance. This is particularly true in grant programs where authorizing agencies frequently want assurance in the auditor's report that this matter has been considered. For such audits auditors should obtain an understanding with the authorizing agency as to the extent to which such positive comments on compliance are desired. When coordinated audits are involved, the audit program should specify the extent of comments that the auditor is to make regarding compliance.

When noncompliance is reported, the auditor should place his findings in proper perspective. The extent of instances of noncompliance should be related to the number of cases examined to provide the reader with a basis for judging the prevalence of noncompliance.

APPENDIX I

QUALIFICATIONS OF INDEPENDENT AUDITORS

ENGAGED BY GOVERNMENTAL ORGANIZATIONS

When outside auditors are employed for assignments requiring the expression of an opinion on financial reports of governmental organizations, only fully qualified public accountants should be employed. The type of qualifications, as stated by the Comptroller General, deemed necessary for financial audits of governmental organizations and programs is quoted below:

"Such audits shall be conducted \*\*\* by independent certified public accountants or by independent licensed public accountants, licensed on or before December 31, 1970, who are certified or licensed by a regulatory authority of a State or other political subdivision of the United States: Except that independent public accountants licensed to practice by such regulatory authority after December 31, 1970, and persons who although not so certified or licensed, meet, in the opinion of the Secretary, standards of education and experience representative of the highest prescribed by the licensing authorities of the several States which provide for the continuing licensing of public accountants and which are prescribed by the Secretary in appropriate regulations may perform such audits until December 31, 1975; provided, that if the Secretary deems it necessary in the public interest, he may prescribe by regulation higher standards than those required for the practice of public accountancy by the regulatory authorities of the States."<sup>1</sup>

<sup>1</sup>Letter (B-148114, Sept. 15, 1970) from the Comptroller General to heads of Federal departments and agencies. The reference to "Secretary" means the head of the department executing the instrument in which the quotation appears.

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# ***Internal Auditing in Federal Agencies***

UNITED STATES GENERAL ACCOUNTING OFFICE  
1974

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INTERNAL AUDITING  
IN  
FEDERAL AGENCIES

Basic principles, standards, and concepts

UNITED STATES  
GENERAL ACCOUNTING OFFICE  
1974

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## FOREWORD

*The need for effective internal auditing systems in the Federal agencies has been recognized by the Congress in a number of laws, particularly the National Security Amendments of 1949 and the Budget and Accounting Procedures Act of 1950.*

*Under the Budget and Accounting Procedures Act of 1950, the Comptroller General, in carrying out his audit responsibilities, is required to prescribe principles, procedures, rules, and regulations for carrying out such work, giving*

*"\* \* \* due regard to generally accepted principles of auditing, including consideration of the effectiveness of \* \* \* internal audit and control, and related administrative practices of the respective agencies."*

*That act further requires the head of each agency to establish and maintain systems of*

*"\* \* \* internal control designed to provide \* \* \* effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit."*

*The General Accounting Office issued statements of basic principles and concepts of internal auditing for Federal agencies in 1957 and 1968 to assist in carrying out the principles enunciated in the act and to provide guidance to the agencies in developing internal audit organizations and procedures.*

*In 1972, we published a comprehensive statement of standards for audit of governmental organizations, programs, activities and functions. This statement is applicable to internal auditing in governmental organizations--Federal, State, and local--as well as to external and contract auditing conducted by or for governmental entities. A summary of these standards is attached as appendix A.*

*Because of the general applicability of these standards in the auditing of Government programs and activities, we have integrated them into this revised statement of basic principles, standards, and concepts of internal auditing in Federal agencies.*

*The Government Activities Subcommittee, House Government Operations Committee, has taken an active interest in internal audit activities and it issued an important and constructive statement on the subject in 1963. A copy of the pertinent excerpts from the Committee's report is attached as appendix B.*

*The General Accounting Office has issued numerous reports to the Congress appraising the effectiveness of internal auditing in individual Federal agencies. In carrying out our statutory responsibilities, we expect to make additional reports from time to time bearing upon the adequacy of this important function in all Federal agencies.*

*As contemplated in the Budget and Accounting Procedures Act of 1950, it is essential that significant internal audit findings be made available directly to the head of the agency concerned and that he assure himself of the adequacy of staffing and the scope of internal audit arrangements in his agency. Evaluating the adequacy and effectiveness of these arrangements will continue to be an important part of our work.*

  
Thomas B. Staats  
Comptroller General  
of the United States

August 1974



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## INTERNAL AUDITING IN FEDERAL AGENCIES

### BASIC PRINCIPLES, STANDARDS, AND CONCEPTS

#### MANAGEMENT CONTROL

Management control begins with delegated authority and planned operations and continues through performance and reporting on performance. A well-designed system of management control helps to insure efficiency, economy, and achievement of planned results. Such a system includes providing carefully devised and frequently updated standards of comparison in accordance with which activities are designed and carried on, and against which their output, whatever its form or stage of completion, can be measured.

The essence of management control is the action which adjusts operations to conform with prescribed or desired standards or requirements. To take this action, management needs timely and adequate information on performance.

#### ROLE OF INTERNAL AUDITING

Information needed by management may come from direct observation; from routine and periodic operating, accounting, statistical, and analytical reports; and from functional or staff reviews. Another important source of information is the internal audit organization which conducts independent examinations and makes reports on its findings and appraisals of operations and performance. The internal audit function uniquely supplements routine management checks through its independent approach and methods of review. This function is one of the essential tools of management, complementing all other elements of management control.

#### Nature of internal auditing

The overall objective of internal auditing is to assist agency management in attaining its goals by furnishing information, analyses, appraisals, and recommendations pertinent to management's duties and objectives.

Internal auditing is a staff and advisory function, not a line-operating function. Thus, the internal auditor should not have authority to make or direct changes in his agency's procedures or operations. His job is to independently and objectively analyze, review, and evaluate existing procedures and activities; to report on conditions found; and, whenever he deems it necessary, to recommend changes or other action for management and operating officials to consider.

An internal auditor should not be given direct operating responsibilities. Rather, he should be expected to concern himself primarily with the performance of others, to retain an independent outlook in all of his work, and to direct particular attention to matters requiring corrective action. His function is to present his views and suggestions constructively in such a manner as to stimulate or encourage action on his suggestions by others.

### Benefits of internal auditing

Management has found that services rendered by the internal auditor in the form of constructive recommendations supported by unbiased, relevant information have aided in meeting many of the problems of both large-scale and decentralized operations. The numerous, complex administrative problems of large organizations impose on management the necessity of delegating a large degree of operating authority within the organizational structure. Management must keep informed on what is happening in the organization at its various levels. Internal auditing is an important means by which management can provide itself with such information and related evaluations.

Management also benefits from timely information on problems on which remedial measures can be taken before the functioning of the organization is impaired. These problems, once they have been examined and appraised, often lead to opportunities for achieving lower costs, increased efficiency, and faster ways of getting things done.

Internal auditing can be of special benefit to the management of smaller organizations, or of small segments of large organizations, where the customary division of duties among employees is not always economical or practical. The internal auditor can often provide additional internal checks and controls required for effective and efficient management.

*By reason of his knowledge of management policies and procedures and his contacts with officials and employees at all*

organizational levels, the internal auditor can render a valuable service by promoting better communication within an agency. He can obtain first-hand observations on the usefulness or effectiveness of prescribed policies and procedures and he can bring to top management's attention those needing modification, explanation, and interpretation. This type of service can contribute greatly to good management control.

### Federal Management Circular

General Services Administration Federal Management Circular 73-2, dated September 27, 1973, sets forth policies to be followed in the audit of Federal operations and programs by executive departments and establishments. The primary objectives of this circular are to promote and improve audit practices, to achieve more efficient use of manpower, to improve coordination of audit efforts, and to emphasize the need for early audits of new or substantially changed programs.

### Congressional interest

The Congress recognized the role and usefulness of internal auditing when it passed the National Security Act Amendments of 1949 and the Budget and Accounting Procedures Act of 1950. The last-named act placed responsibility for the institution of this element of internal control on top agency management by providing (in section 113) that:

*The head of each executive agency shall establish and maintain systems of accounting and internal control designed to provide \* \* \* effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit \* \* \*.*

Other more recent laws which require internal audits of agency activities include the Postal Reorganization Act of 1970 and the District of Columbia Self-Government and Governmental Reorganization Act of 1973.

The Government Activities Subcommittee, House Government Operations Committee, has taken a strong and active interest in this function in the Federal Government, urging all agencies to adopt effective internal audit systems.<sup>1</sup>

<sup>1</sup>House Rept. 456, 88th Cong. 1st sess. (1963). See excerpts from Committee's report in app. B.

To be of maximum usefulness, the scope of the internal auditor's activity should not be restricted. It should extend to all agency activities and related management controls.

The duties of the internal auditor should be clearly stated by the head of the agency, and information concerning these duties should be disseminated throughout the agency to insure full recognition of the nature of his functions at all levels.

#### Appraising performance

A necessary function of management is to establish and prescribe policies, plans, and procedures for carrying out programs and activities in pursuit of the objectives of the organization and to establish organizational or management systems for review of operations.

The internal audit function can provide a highly valuable service to management by reviewing, appraising, and reporting on the extent and nature of internal compliance with management's policies, plans, and procedures as well as with applicable legal and external regulatory requirements.

The internal auditor's work should include the review of the operation of the whole system of management controls over operations and resources to ascertain whether they are functioning in accordance with their design and are functioning effectively. In organizing his work, particularly in large agencies, he should consider making comparative examinations of similar functions which are performed in the various organizational components of the agency.

In making such examinations, the internal auditor should be alert to possibilities for improving operations and identifying opportunities for bringing about greater efficiency and economy.

As a result of his familiarity with management plans and policies, intra-agency relationships, and procedures and with the manner in which they are working out, the internal auditor should also report observations as to their adequacy and effectiveness in relation to top management objectives together with such recommendations for improvement he considers appropriate.

The full scope of an audit of a governmental program, function, activity, or organization should encompass:

- An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
- A review of efficiency and economy in the use of resources.
- A review to determine whether desired results are effectively achieved.

This scope of audit is explicitly set forth as a general standard for governmental auditing in GAO's statement of audit standards (app. A), but it does not imply that every internal audit should be so extensive. Internal audit work should be tailored to meet the needs of management and other users having a legitimate interest in the audit results.

The needs of management officials for assistance of the kind that internal auditors can provide will vary from agency to agency because of differences in nature of operations, organizational structure, location of activities, qualities and competence of officials and employees, and concepts of management control held by top agency officials. An internal audit program should be structured to meet the needs of top management and also be designed to serve the needs of subordinate management levels.

### Examining financial operations

The internal auditor should examine financial transactions, including the receipt and disbursement of public funds; accounts; and financial reports to the extent necessary to determine whether:

- The agency is maintaining effective control over revenues, expenditures, assets, and liabilities.
- The agency is properly accounting for its resources, liabilities, and operations.

--The agency's financial reports contain accurate, reliable, and useful financial data and are fairly presented.

--The agency is complying with the requirements of applicable laws and regulations.

In carrying out this work, the internal auditor should evaluate the adequacy of the agency's prescribed policies and procedures and the internal controls related to its financial operations, including the accounting and financial reporting.

The internal auditor should examine whether all revenues arising from the agency's activities were collected and fully accounted for and whether expenditures were made for approved purposes and were properly authorized. He should evaluate whether the agency's procedures result in prices, rates, or fees that conform to applicable laws and regulations.

Prescribed procedures for expenditures should be similarly reviewed for such conformity.

The work of the internal auditor should include examination and testing of accounting and other records and the related procedures underlying the agency's management information system to establish the reliability of the data used by management for internal purposes and for external reports.

The purpose and usefulness of internal reports should be reviewed by the internal auditor as one means of keeping reports responsive to the real needs of users, of avoiding the production of repetitive reports that no longer serve any useful purpose, and of avoiding the distribution of reports to persons having no use for them. He should also ascertain whether changing activities or circumstances are considered in the internal reporting operations.

The internal auditor should be particularly concerned with assets for which the agency is accountable--whether they are fully accounted for and whether procedures being followed adequately protect them from loss, deterioration, or misuse. In examining these matters, he should be alert to the possibility of fraud and dishonesty and to opportunities and practices which could lead to fraud, dishonesty, or loss.

The existence of separate groups within the organization concerned with fraud or other forms of irregularity should not inhibit the auditor from giving close attention to such matters



in his work. When he does encounter such matters, the internal auditor should bring them without delay to the attention of the management.

### Evaluating efficiency and economy

The internal auditor should be concerned at all times with minimizing unnecessary or wasteful practices in the use of the agency's resources. He should be watchful for and report on such possibilities as:

- Procedures, whether officially prescribed or merely followed, which are ineffective or found to be more costly than justified.
- Duplication of effort by employees or between organizational units which, if eliminated, could increase overall efficiency.
- Performance of work which serves little or no useful purpose.
- Inefficient or uneconomical use of equipment.
- Overstaffing in relation to work to be done.
- Faulty buying practices.
- Procurement and accumulation of unneeded or excess quantities of property, materials, or supplies.
- Wasteful use of property.

Where functional staff groups exist in an agency which are regularly concerned with such matters as organizational efficiency and personnel use and the making of related studies, the internal auditor should recognize such work and avoid any duplication of effort. However, he should communicate to such groups any observations he may have which are related to their responsibilities.

The operations of such functional staff groups should be subject to the same degree and type of audit as are other parts of the organization.

When practicable, the internal auditor should suggest ways of remedying the weaknesses that he finds; in some cases, he may recommend remedial studies by technical personnel.

### Reviewing program results

A review of the results of programs or activities involves inquiring into the results or benefits achieved and whether the programs or activities are meeting established objectives.

Agency management officials have the basic responsibility for continually evaluating their programs and activities to determine the progress being made in achieving established objectives. The auditor whose scope of operations extends to reviewing program results should be initially concerned with evaluating the agency's system for measuring its progress or accomplishments. Major questions he should consider include:

*Program effectiveness*--Is the program accomplishing the results intended, as spelled out in the legislative objectives or in the implementing directives of the agency?

*Cost effectiveness*--Is the program succeeding within the costs anticipated at the time the legislation was enacted?

*Adequacy of information system*--Does top management have the essential and reliable information necessary to exercise supervision and controls and to ascertain direction or trends?

*Cost-benefit relationship*--Are program costs reasonably commensurate with the benefits achieved?

*Consideration of alternatives*--Have alternative programs or procedures been examined or should they be examined for potential in achieving objectives with the greatest economic efficiency?

*Need for program*--Is there a continuing need for the program? Legislation and regulations may not provide for program termination, and it is not unusual for a Government program to continue long after the need it was created to meet has disappeared.

*Appropriateness of program*--Is the program, as it was designed and implemented, geared to the needs of the particular target group that was used to justify the establishment of the program?

*Clarity and consistency of objectives*--Are program objectives sufficiently clear to permit agency management to effectively accomplish the desired program results? Are the objectives of the component parts of the program consistent with overall program objectives?

In all of his work, the internal auditor should strive to determine the underlying causes of the errors or adverse conditions he encounters and to formulate recommendations for preventing similar occurrences in the future.

The internal auditor should not be assigned the responsibility for developing and installing methods, systems, or procedures. He should, however, call attention to problem areas and possible improvements and he should be consulted on proposed corrective actions.

The internal auditor should be kept informed of proposed major changes in methods, systems, and procedures, particularly those involving computer applications, so that he can contribute suggestions on them before they are put into effect. Consultation between the systems/computer technicians and the internal auditor, during the systems development phase, helps to insure that adequate controls are established and adequate audit trails are provided in the system so as to avoid costly changes after a new system has been installed.

## PERSONNEL QUALIFICATIONS

The staff assigned to perform an audit must collectively possess adequate professional proficiency to perform the tasks required.

Carrying out the type of internal audit described above requires an adequate staff of competent, experienced personnel. The degree to which internal auditing can aid management is proportional to the capabilities of the audit staff and the freedom with which it operates. A program of continuous training and development is essential.

Broad responsibilities and a wide range of services require that the internal auditor be well informed on such matters as his agency's purposes, objectives, programs, policies, operations, activities, and related basic legislation; its budget, fiscal, and accounting procedures and those of the Federal Government generally; legal and regulatory requirements; accounting and auditing principles and procedures; and management practices common to all organizations.

Within the scope of his assigned responsibility, the internal auditor should be capable of making audits at the various

operating levels within the organization. He should be able to recognize problem areas and contribute workable suggestions for improvement. The internal audit manager must see that all audits are conducted by personnel who collectively have the skills necessary for the type of audit that is to be performed.

The qualifications of the staff assigned to the audit should be commensurate with the scope and complexities of its audit assignments. Audits vary in purpose and scope. Some require an opinion on financial statements and an evaluation of compliance with specific laws and other requirements; others require reviews of efficiency and economy; still others emphasize a review of effectiveness in achieving program results; and some require all three elements. Performing all three elements will usually require a wide variety of skills.

Because there are variations in program objectives and organizational forms, as well as differences in laws, rules, and regulations applicable to such programs, the qualifications mentioned herein should apply to the skills of the audit organization as a whole and not necessarily to individual auditors. For example, if an audit organization includes staff members or consultants with acceptable skills in accounting, statistics, law, engineering, actuarial science, and other fields, each individual member of the organization need not himself possess all of these skills.

The internal audit staff must be knowledgeable in auditing theory and procedure, statistical techniques-including sampling-computer operations and applications, management information systems, economics, operations research, governmental organization and operation, and other facets of modern management practices. While an audit staff may consist mostly of individuals with training and experience in accounting and auditing, it should also include or acquire through the medium of contract consultants expertise in mathematics, computer operations, engineering, and other appropriate specialities when warranted by the nature of an agency's programs and activities.

The nature of his work requires the internal auditor to deal successfully with all classes of employees and to be able to communicate with them and others both orally and in writing. He must be tactful and always maintain a good appearance and a professional bearing.

During their examinations, internal auditors have opportunities for becoming acquainted with agency problems and

personnel. The investment of talent and time in internal auditing can also make a material contribution to the development of potential management personnel.

## LOCATION IN THE ORGANIZATION

### Responsibility of management officials

Internal auditing does not in any way relieve other persons of the responsibilities assigned to them. An internal auditor should not replace established lines of operating authority, and his operations do not eliminate the need for continuing organizational and functional supervision.

Operating officials should be vested with full responsibility for compliance with prescribed policies and procedures, for protection and use of the resources of the agency, and for action in the correction of deficiencies or unsatisfactory conditions coming to their attention, including those reported by the internal auditor.

### Independence and reporting level

The position of the internal auditor in the organization should be such that he is independent of the officials who are directly responsible for the operations he reviews. To provide an adequate degree of independence, *the internal auditor should be responsible to the highest practical organizational level, preferably to the agency head or to a principal official reporting directly to the agency head.*

Such positioning is in accordance with the general standard for governmental auditing which places upon the auditor and the audit organization the responsibility for maintaining sufficient independence so that their opinions, conclusions, judgments, and recommendations will be impartial.

Internal auditing cannot be fully effective unless the official to whom the internal auditor reports is a strong supporter of the function, has direct access to the agency head, and has made arrangements to supply all significant audit findings directly to the agency head.

Where the internal auditor does not report to the head of the agency, the function should be placed under the direction of a principal official who does report directly to the agency head so as to insure recognition of its stature and importance in the control system. Also, where the internal auditor does not report to the head of the agency:

--The agency head should satisfy himself that the official to whom the internal auditor reports not only permits but also encourages the internal auditor to exercise latitude in setting the scope of work and in reporting on the results of his audits. The internal auditor should be sufficiently independent to be able to make impartial appraisals of the operation of agency programs and activities, including those under the official to whom the internal auditor reports.

--The head of the agency should concern himself with the scope and effectiveness of the internal audit function and its staffing and with the adequacy of attention paid to audit findings and recommendations.

--The internal auditor, when he deems it necessary to the fulfillment of his responsibilities, should have direct access to the head of the agency.

### Centralization

The establishment of a single internal audit organization reporting to the agency head or to a principal official reporting directly to the agency head:

--Provides the advantages of greater independence.

--Fosters a broad viewpoint on the interrelationship of organizations and functions within an agency.

--Places the internal auditor in a better position to make systematic and independent evaluations of and reports on all agency programs, activities, and operations.

A single audit organization also facilitates the attraction and retention of better managerial and staff capability, more effective staff use, and increased coordination of audit effort and interrelated findings. In addition, under unified direction and supervision, a single audit organization permits the devotion of a greater portion of total staff time to specific audit assignments and provides greater opportunities for tailoring staff assignments to the talents and experience of staff members.

### Audit staffs in subordinate organizations

A separate internal audit staff should not be attached to a component bureau or similar organization unless management

needs and the size and nature of the bureau's activities are such as to justify an internal audit staff of sufficient size to attract and retain qualified personnel and to make possible the productive and flexible use of staff resources. Decisions on the establishment of such staffs should be made by or be subject to approval by the agency head.

Where an organizational component of an agency maintains its own internal audit staff, the central internal audit activity of the agency should be accountable for furnishing general policy direction and coordinating the efforts of such staff.

The audit coverage by a subordinate audit staff should be included in the scope of the internal audit activity provided for top management. The work of such an organization should be used to the extent practicable in carrying out internal audit work of the top audit group and the effectiveness of the audit work at the lower level should be evaluated as are other control functions.

An internal audit group at the bureau level should be accountable to an official occupying a sufficiently high position to insure its access to any activity of the organization and adequate consideration of and action on its findings and recommendations.

## MANAGEMENT OF THE INTERNAL AUDIT FUNCTION

### Due professional care

Due professional care must be used in conducting internal audits and in preparing related reports.

This standard of performance requires the auditor to exercise good judgment in devising audit tests and procedures and to do a good job in applying them and in preparing reports. He must effectively supervise his assistants to the extent appropriate in relation to their abilities (see below), maintain effective working relationships with officials of the activity audited, and arrange to follow up on his findings and recommendations.

This standard of performance requires the auditor to be alert for indications of fraud, improper or illegal expenditures or operations, inefficiency, waste, or ineffectiveness. It does not mean, however, that he must make a detailed audit of all

transactions or operations to insure that no material impropriety exists.

It is management's responsibility to institute effective procedures and controls to prevent irregularities and improprieties and to encourage efficient and effective operations under adopted policies and procedures. The auditor's job should be to test these procedures and controls rather than to function as a substitute for them.

#### **Audit manual**

A manual should be developed outlining the objectives of internal auditing in the agency, the policies to be followed, the general scope of work to be performed, standards of performance, and reporting requirements.

#### **Planning**

Adequate planning of audit work, a basic examination and evaluation standard for governmental auditing, is essential to identify the areas to be covered by the audit staff and to permit systematic scheduling of work and the best use of manpower. However, audit plans should be sufficiently flexible to permit special examinations as new needs or changing circumstances require, thus making possible the best service to management.

Where the audit work includes reviews of the efficiency and economy of operations or achievement of desired results, adequate planning is especially important because the procedures employed in such audits are more varied and complex and, thus, more care is needed to select the appropriate procedures for the case at hand.

Adequate planning should include planning for:

- Coordination with other audit groups, as appropriate.
- Personnel to be used on the assignment.
- Work to be performed.
- The format and general content of the report to be issued.



A written audit program should be prepared for each audit to effectively communicate audit objectives to all staff members, to facilitate control of the audit work during the review phase, and to provide a permanent record of the audit plans. The programs should include any available underlying criteria of performance, including reference to pertinent laws and regulations, to be used for evaluation purposes. When the established criteria for performance are vague, the auditor should attempt to obtain authoritative interpretation of the criteria. If the auditor is required to select measurement criteria, he should strive to reach agreement on the appropriateness of these measures with the interested parties.

Audit programs should include information on :

- Objectives and scope of the audit.
- Background information needed for an understanding of the audit objectives and the operations of the program or activity to be audited.
- Definitions of unusual terms.
- Audit procedures.
- Reporting procedures.

### Supervision

Another basic examination and evaluation standard for governmental auditing pertains to supervision of audit assistants. This standard requires that such assistants be properly supervised.

This standard places upon the audit organization the responsibility for insuring that less skilled staff members receive appropriate guidance in the performance of their work. Since training, experience, and other qualifications vary among auditors, specific work assignments must be commensurate with abilities.

The standard also requires that the work of other auditors or professional consultants engaged as a part of an internal audit assignment be subject to the supervisory review of the internal audit staff management.

Supervisory review should be directed to both the substance and the method of auditing. The review should insure that (1) conformance with audit standards is obtained, (2) the audit programs are followed, unless deviations are justified and authorized, (3) the working papers adequately support findings and conclusions, (4) the working papers provide adequate data for preparing a meaningful report, and (5) the auditor will accomplish the audit objectives. Documentation of supervisory reviews should be prepared and retained.

To keep pace with changing conditions, top management should, from time to time, reappraise the agency's internal audit and other internal review activities, especially their coverage and their relationship to changes in the agency's policies and programs. Such appraisals should consider the need to modify the policies and procedures of these activities as necessary to keep them responsive to the current interest of management and other interested parties, and insure continued functioning with minimum interference with operating activities, without duplication of effort, and at reasonable cost.

### **Evidence and working papers**

Obtaining sufficient, competent, and relevant evidence to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations is another basic examination and evaluation standard for governmental auditing.

Working papers prepared during an audit phase should contain evidence to clearly support the auditors' conclusions and any recommendations made or other observations reported. The evidence gathered and used as supportive material should, in all cases, meet high standards of competence, reliability, and objectivity.

The working papers should (1) be complete and accurate, (2) be clear and understandable, (3) be legible and neat, and (4) contain only those materials directly pertinent to the audit and the related report.

### **INTERNAL AUDIT REPORTS**

The preparation of audit reports is an important part of the internal audit process since it is primarily through reports that the auditor communicates his observations, findings, conclusions, and recommendations.

All significant audit findings should be brought to the attention of the agency head and other users of audit information in such written form as to make it easy for them to effectively use the information.

Written internal audit reports should be submitted to:

- Management officials who are responsible for the operations or activities reviewed and for making decisions as to actions to be taken on reported findings and recommendations.

- The official to whom the internal auditor is functionally responsible.

- Other officials in the agency who may benefit from the information in the reports.

Top management's role is essential here. By its inattention or inaction, much of the constructive benefit of the internal auditor's work can be lost. On the other hand, its interest in and use of his findings and recommendations can contribute much to the recognition of the importance of his work at all management levels.

The need to prepare written audit reports is not intended to limit or prevent discussions of findings, judgments, conclusions, and recommendations with persons who have responsibilities involving the area being audited. On the contrary, such discussions should be encouraged in order to provide management officials with useful and timely information. However, regardless of whether such discussions are held, a written report should be prepared. On those occasions where corrective action is taken or promised, a less formal type of report, such as a letter to summarize the findings and recommendations and related action or commitment, may suffice.

There are a number of reasons why reports should be prepared in written form:

- So that the results can be widely communicated to responsible officials at all levels of management.

- To make the auditor's findings and recommendations less susceptible to misunderstanding.

--To make the auditor's findings available for public inspection, when appropriate.<sup>1</sup>

--To facilitate subsequent followup work to determine whether appropriate measures have been taken in response to the auditor's findings and recommendations.

### Timeliness

The value of an audit report is directly related to its timeliness concerning any action required to be taken. Therefore, audit reports should be issued as promptly as possible to make information available for timely use by management and by other interested parties.

The auditor should consider interim communication of significant matters to appropriate officials during his audit work. Such communication is not a substitute for a final written report, but it does alert officials to matters needing correction at an earlier date and permits these officials to institute corrective measures earlier than is possible if the auditor's findings and recommendations are withheld until his final report is completed.

### Content

To be effective, audit reports must be carefully prepared and:

--Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.

--Present factual matter accurately, completely, and fairly.

--Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.

--Include only factual information, findings, and conclusions that are adequately supported by enough

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<sup>1</sup>There are a number of situations where law or regulations prevent issuance of internal reports. Generally, internal auditors should be guided by the practices adopted by their agency for compliance with the Freedom of Information Act.

evidence in the auditor's working papers, to demonstrate or prove, when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.

- Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
- Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in balanced perspective of any unusual difficulties or circumstances faced by the operating officials concerned.
- Identify and explain issues and questions needing further study and consideration by the auditor or others.
- Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
- Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.
- Clearly explain the scope and objectives of the audit.
- State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.

If his audit report contains financial statements or other financial presentations concerning the program or activity audited, the auditor should explain the nature and extent of his audit of such information together with comments on any significant financial issues affecting the reports and compliance with legal or other regulatory requirements.

Each audit report containing financial statements should:

1. Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with other specified accounting principles applicable to the organization, program, function, or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
2. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of noncompliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.

#### FOLLOWUP

Primary responsibility for action and followup on audit recommendations rests with management. A good control system will include procedures under which management officials will evaluate the effectiveness of actions taken on audit recommendations.

A desirable procedure is to have regular status reports prepared for the information of management officials and the internal auditors, as to actions taken on audit recommendations. Also, provision should be made for regular inquiry into whether proposed corrective actions have, in fact, been taken and their effectiveness. The responsibility for such followup should be that of management officials, but the internal auditors should participate.

Where operating officials disagree with the internal auditor's recommendations, mechanism should be established to reconcile the differences or to call for a decision at a higher management level.

Thus, reporting a finding, observation, or recommendation should not end an internal auditor's concern with the matter. From time to time he should ascertain whether his recommendations have received serious management consideration and whether satisfactory corrective action has been taken.

Internal auditors should also concern themselves with the audit findings of the General Accounting Office and other audit agencies or groups which contain recommendations as to actions to be taken by the agency. They should incorporate, in their followup procedures, inquiry into the nature and effectiveness of those actions.

#### **RELATIONSHIP OF INTERNAL AUDITING TO OTHER AUDITS PERFORMED BY AGENCIES**

Auditing of the performance and records of third parties, such as contractors, grantees, or borrowers, is an essential aid to the administration of contracts and of grant and loan programs. The degree of interrelationship between such auditing and internal auditing will vary depending upon the nature, size, and scope of agency programs.

Contract auditing by an agency serves the purpose of determining whether the contractor is complying with contract requirements for the goods or services being supplied to the agency. In the award and administration of negotiated contracts, it is usually necessary to make examinations of requests for cost reimbursement; of the currency, completeness, and accuracy of cost and pricing data used in pricing negotiations; and of activities generating costs to the extent an agency's interests are affected. This type of auditing enables the agency to appraise a contractor's financial responsibility to the Government and to provide information necessary to contract negotiation and administration. It is an essential part of an agency's system of control for achieving its purposes efficiently and economically.

Similarly, the records and performance of grantees or borrowers are subject to audit by the responsible agency as a means of ascertaining whether there has been compliance with

the terms and objectives of the agreements under which Federal funds are granted or loaned. Such auditing, like contract auditing, is an integral part of an agency's system of control in achieving its purposes effectively and efficiently.

The location in the organization of the audit staff responsible for auditing third-party records and performance should be such as to insure that the function effectively serves the program operating officials directly concerned as well as top management and that available audit staff resources are effectively used.

A separate organization of such auditors will be appropriate in many cases because of the size of the organization required to carry out the function; the high degree of specialized knowledge required; or the special need for a close association between program management personnel and the audit staff. In other cases, a single integrated organization of all agency auditors may be desirable.

Regardless of the form or organization adopted, provision should be made for independent internal review of the external audit work to ascertain whether it is being carried out properly and efficiently.

#### RELATIONSHIP OF INTERNAL AUDITING TO GENERAL ACCOUNTING OFFICE AUDIT RESPONSIBILITIES

The adequacy of the system of internal control, including internal audit, of each Federal agency is of importance to the General Accounting Office in carrying out its statutory audit responsibilities. The Budget and Accounting Procedures Act of 1950 states the duty of the General Accounting Office to consider agency internal auditing as follows:

*Sec. 117. (a) Except as otherwise specifically provided by law, the financial transactions of each executive, legislative, and judicial agency, including but not limited to the accounts of accountable officers, shall be audited by the General Accounting Office in accordance with such principles and procedures and under such rules and regulations as may be prescribed by the Comptroller General of the United States. In the determination of auditing procedures to be followed and the extent of examination of vouchers and other documents, the*



*Comptroller General shall give due regard to generally accepted principles of auditing, including consideration of the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices of the respective agencies.*

Although there are numerous areas of common interest between the General Accounting Office and an agency's internal auditors, certain basic objectives and responsibilities differ. Internal auditing is an integral part of an agency's system of management control. In its audits, the General Accounting Office is concerned with the entire control mechanism within an agency, including the various arrangements made by the management for internal audits and other forms of inspection, appraisal, and evaluation. If warranted by its evaluations, the General Accounting Office will rely on such work and make full use of it in conducting its examinations.

The General Accounting Office is interested in the degree of agency management concern and interest in the work of the internal auditor and particularly in his reported findings and recommendations. The actions taken by management officials on internal audit recommendations are reviewed by General Accounting Office auditors.

The General Accounting Office uses the same techniques of testing and analyzing, to satisfy itself as to the adequacy of internal audit work, as those used in the review of any other function in a Federal agency. This includes a review of work programs and working papers and their adequacy in relation to what was reported. The review may cover some of the same transactions and procedures as those examined by the internal auditor--a procedure essential in testing the quality of the internal audit work.

General Accounting Office evaluations of internal audit systems also include making inquiries of management and operating officials as to the usefulness of internal auditing to them in their day-to-day operations.

Normally, there is little duplication of the work of the internal auditor. The internal auditor performs his work as part of management's pattern of operation and control. The General Accounting Office review is part of the independent appraisal it makes for the Congress of the manner in which Federal agencies discharge their responsibilities and of the effectiveness of their control systems including internal audit.

It makes every effort to keep abreast of the planned work programs of the agency's internal auditors, to consider them in planning its own work, and to avoid, wherever possible, conflicts in audit schedules.

Free and unrestricted access to working papers, records, and reports prepared in connection with internal audit work and other internal review activities is essential for General Accounting Office auditors to effectively review and evaluate their propriety and adequacy. Ready access to such records is also necessary in order that all significant information pertinent to any matter being reviewed by the General Accounting Office may be considered. Such information is necessary in order that, to the extent possible, General Accounting Office findings and reports will be complete, accurate, and objective and thus of maximum usefulness to the Congress and to agency and other Government officials.

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## APPENDIXES

## SUMMARY OF GOVERNMENTAL AUDIT STANDARDS <sup>1</sup>

The audit standards below are intended to be more than the mere codification of current practices tailored to existing audit capabilities. Purposely forward-looking, these standards include some concepts and areas of audit coverage which are still evolving in practice but which are vital to the accountability objectives sought in the audit of governments and of intergovernmental programs. Therefore, the audit standards have been structured so that each of the three elements of audit can be performed separately if this is deemed desirable.

### General Standards

1. The full scope of an audit of a governmental program, function, activity, or organization should encompass:
  - a. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
  - b. A review of efficiency and economy in the use of resources.
  - c. A review to determine whether desired results are effectively achieved.

In determining the scope for a particular audit, responsible officials should give consideration to the needs of the potential users of the results of that audit.

2. The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.

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<sup>1</sup>Excerpts from *Standards for Audit of Governmental Organizations, Programs, Activities & Functions*, Comptroller General of the United States (Washington, D.C., U.S. General Accounting Office, 1972.)

APPENDIX A

3. In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.
4. Due professional care is to be used in conducting the audit and in preparing related reports.

**Examination and evaluation standards**

1. Work is to be adequately planned.
2. Assistants are to be properly supervised.
3. A review is to be made of compliance with legal and regulatory requirements.
4. An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance with laws and regulations, and to provide for efficient and effective operations.
5. Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations.

**Reporting standards**

1. Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Copies should also be made available for public inspection.
2. Reports are to be issued on or before the dates specified by law, regulation, or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.

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3. Each report shall:
  - a. Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
  - b. Present factual matter accurately, completely and fairly.
  - c. Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.
  - d. Include only factual information, findings, and conclusions that are adequately supported by enough evidence in the auditor's working papers to demonstrate or prove, when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.
  - e. Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
  - f. Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in balanced perspective, recognizing any unusual difficulties or circumstances faced by the operating officials concerned.
  - g. Identify and explain issues and questions needing further study and consideration by the auditor or others.
  - h. Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.

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- i. Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.
  - j. Clearly explain the scope and objectives of the audit.
  - k. State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.
4. Each audit report containing financial reports shall:
- a. Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with other specified accounting principles applicable to the organization, program, function, or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
  - b. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including

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instances of noncompliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.



Excerpts from Report by the House Committee on  
Government Operations on "Survey of Selected  
Activities (Part 1 - Efficiency and Economy in the  
Department of Commerce)"

House Report No. 456,  
88th Congress, 1st Session (1963)

Findings and Conclusions

1. *Internal Audit*

Every organization must have an effective system of internal management control. The so-called internal auditing system, as recommended by the Comptroller General in August 1957, constitutes an effective means for the average Federal agency to obtain this essential management function. Unfortunately, this internal audit system has not been adopted on a Government-wide basis. In too many instances, internal audit functions are compromised by inadequate staffs, improper organizational requirements or limits in scope of service. All Federal agencies should review internal management control systems and place them in compliance with the Comptroller General's 1957 recommendations and with the criteria established in this report.

\* \* \* \* \*

Need for Effective Internal Audit Systems

In the larger Federal agencies, the most promising means of obtaining management control has been the establishment of effective internal audit systems. The Comptroller General in 1957 issued a statement of basic principles and concepts for departments and agencies to follow in the establishment of such systems. For years the Comptroller General and those on his staff working on a day-by-day basis with executive officials have continuously stressed the need for effective internal management controls. The head of a large executive department or agency must have his own "eyes and ears" within the organization, responsible solely to him, independent of operations and with unlimited jurisdiction to review any and all functions wherein waste or inefficiency might exist. \* \* \* However, especially in the larger departments or agencies employing thousands of individuals, involving scores of

APPENDIX B

programs, and having offices located throughout the United States and possibly abroad, if the agency head wants to maintain policy control and achieve economy and efficiency, he has no choice but to institute an effective management control system.

Today, there are internal audit groups sprinkled throughout the agencies and departments of Government. The term is well recognized. Unfortunately, recognition of the need for effective internal audits has not always been translated into the establishment of such systems. While many exist, there is considerable room for general improvement.

The committee has established certain fundamentals relating to internal audit operations patterned after the 1957 recommendations of the Comptroller General, with certain refinements reflecting deficiencies in operations uncovered during the hearing:

1. There must be a central internal audit system in every large department or agency organized independent of department or agency operations.
2. The personnel assigned to this management function must have the highest qualifications and the complete confidence of the department or agency head. An accounting background and auditing experience is preferred.
3. All reports and recommendations of the internal audit staff must be submitted in full directly to the agency or department head.
4. The scope of review of the internal audit staff must be unlimited.
5. Personnel assigned to the internal audit function must be protected from recriminations and arbitrary personnel action resulting from the adverse effect their reports might have upon other department or agency employees.
6. The reports and recommendations of the internal audit staff must remain available to the Comptroller General and appropriate congressional committees.

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ILLEGIB

MEMORANDUM FOR: Deputy Director for Support

SUBJECT : Inspector General's Survey of the  
Office of Personnel

REFERENCE : Memo dtd 9 July 1971 to ExDir-Compt  
fr DD/S, subj: Report of the Inspector  
General's Survey of the Office of Personnel

1. Your response to the Inspector General's survey of the Office of Personnel is entirely satisfactory. After the Director of Personnel has completed his review of the allocation of resources to the Position Management and Compensation Division, I shall be interested in having a report from him.

2. In this connection, it seems to me that Recommendation No. 15 is particularly important, since I believe it is intended to imply that the Position Management and Compensation Division, somewhat expanded, can audit manpower utilization in the Agency. This is certainly a job which needs to be done periodically. I should like to request that the Director of Personnel and the Director of Planning, Programming, and Budgeting consider their present responsibilities and submit to me specific recommendations on how our current monitoring and auditing of manpower and personnel utilization can be improved.

  
L. K. White

Executive Director-Comptroller

cc: D/PPB

S E C R E T

reporting should be reduced, e.g., from monthly to quarterly during the conversion period. SRB maintains a master library of current reports, and requesting components should be asked to cancel their existing requirements wherever possible and to use the reports in the SRB library or to make Xerox copies of them at their own expense.

Position Management and Compensation Division

23. The Position Management and Compensation Division (PMCD) has a T/O of [REDACTED] The division 25X9 is made up of two branches, Intelligence & Support, and Scientific & Clandestine Service.

24. The division is charged with responsibilities under the following regulations:

"The Agency will conduct a continuing program of manpower resources management which will assure maximum efficiency and economy in the use of manpower consistent with the Agency's assigned missions and responsibilities" [REDACTED] and,

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"In setting up occupational categories and pay levels for Agency positions it is Agency policy to follow the concepts and principles of the Classification Act of 1949, as amended, as a means for establishing effective internal position alignment, maintaining reasonable comparability with other Government agencies, and simplifying adjustments to conform to Federal salary changes and employment benefits. Overall objectives are to maintain an Agency staffing pattern which will attract and retain highly qualified and competent employees and which will reflect the characteristics of Agency employment, and to provide an effective means of controlling expenditures for personal services" [REDACTED]

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25. The organization and control of manpower is of course one of the most basic of management responsibilities. The Agency operates under a staff manpower ceiling as established by the Congress and the Office of Management and Budget. Each component in the Agency is assigned a staffing complement which identifies the positions to which personnel will be assigned to carry out its assigned missions and functions. Additionally, each career service is assigned a Career Service Grade Authorization which controls the maximum number of personnel authorized at each General Schedule grade level. These organizational and manpower controls are built on the basic framework of the Table of Organization (T/O).

26. The T/O of the Agency and the staff manpower ceiling theoretically should be the same numerical figure. In practice this seldom occurs, but there is a continuing effort toward that goal. The T/O reflects not only numbers but also position classifications (job titles) and GS grade levels. All three are vital in controlling manpower utilization.

27. Two items of the T/O, numbers of positions and associated grades, form the framework against which personnel resources are funded. Both require accurate and up-to-date job descriptions to be realistic figures. To the extent that either is badly out of date, higher management levels are deprived of a valuable source of information on the state of the Agency.

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28. On a day-to-day basis, the Office of Personnel is involved in authenticating and issuing staffing complements and revisions, assuring that components adhere to ceiling restrictions, monitoring entrance on duty and transfers of personnel, approving temporary overstrength situations, evaluating proposals to establish or change the number of supergrade and SPS positions, developing and authenticating the career service grade average, and assuring compliance by the components. In performing these tasks it works closely with PPB and the Executive Director-Comptroller. The thrust of these functions is one of liaison and monitoring. However, in the area of position evaluation the Office of Personnel is solely responsible. It is required to assure top management that the positions in the component's staffing complements are accurately evaluated as to occupational category, position description, and pay level. We find a serious short-fall in this specifically assigned function in the Office of Personnel.

29. The Position Management and Compensation Division's primary assignment is position evaluation. The record shows that a disturbing proportion of the Agency is not covered with currently adequate position evaluations. While the record for individual positions evaluated is fairly impressive [REDACTED] in FY-70), the number of components surveyed is not.

25X9

## S E C R E T

Position Surveys by Components

	<u>Number of Components</u>	<u>Maintenance Rate (yrs.)</u>	<u>Maximum Spread (yrs.)</u>	<u>% of Position Descriptions Completed</u>
DCI	5	8.2	3-15	75
DDS	10	7.4	0-14	80.5
DDP	14	3.9	1-10*	50
DDI	10	8.9	1-16	80
DD/S&T	8	3.6	0-10	31.25
Agency	47	6.1	0-16*	63.35

As can readily be seen, the average component survey is being performed on something like a six-year rather than a three-year cycle, which we believe to be desirable. Coverage is erratic with ten components lacking a survey within the past ten years. Approximately one-third of the total positions in the Agency lack a position description. These records reflect a passive reaction on the part of the Office of Personnel to an assigned responsibility. The office has permitted the manpower resources of PMCD to shrink to the point where the division devotes only 34 percent (FY-70) of its manhours to position surveys and individual actions. The rest of the time is spent in reviewing

\*Two components have never been surveyed.



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staffing complements, reacting to grade change requests, preparing planning papers, and making pay adjustments. These latter assignments acquire priority and component position evaluations receive only minimal attention. This situation has been permitted to develop over the past 6-8 years as the division has come to operate on a "brush-fire" approach. The line components that make the most urgent requests for reorganization or position reclassification receive the attention of the all-too-limited resources.

30. The utility of component surveys, in contrast to spot or individual position surveys, is that only through this approach can a meaningful audit be made of the total manpower utilization within a component. A thorough and comprehensive component audit assures management of (1) the proper mix between professionals and clericals, (2) accurate descriptions of each position and occupational category with unique insight into workload and productivity aspects, (3) proper designation of limited and flexible positions relationship, and (4) the correct General Services grade level for each position.

31. In our survey we found PMCD ill-equipped in relation to its total assigned responsibilities. In recent years, the division has lost some of its initiative and has assumed a somewhat passive attitude toward accomplishing its total mission. At the same time we acknowledge the devotion and hard work of the individual members of the division. The Agency uses more than 750 occupational categories and

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S E C R E T

has its full share of complex staffing patterns. These employees have devoted their best talents to maintaining accurate job descriptions, average grade ceilings, and proper pay levels. Their technical skills are not questioned.

32. The present situation calls for positive action on the part of the Office of Personnel. From a high point of over [REDACTED] positions in 25X9 the late 1950s, the division has been curtailed to its present T/O of [REDACTED]

25X9 [REDACTED] We believe it to be seriously understaffed. The Deputy for Plans and Control estimates that a staff of [REDACTED] persons 25X9 is required to adequately perform the total assigned responsibilities. The T/O of the division should be increased to the point where it can carry on its monitoring responsibilities and conduct detailed component position surveys on the three-year schedule.

33. A careful evaluation of the personnel assignments in the division is also in order. Many of the present incumbents are approaching retirement in the next several years. Although CTs have moved in and out of the division, the main staff of professional classifiers has remained static. An organized rotation plan for senior classifiers has been lacking and should be instituted. A review at this time should develop a rotational plan (6-8 years) and schedule the introduction of new blood at all levels in the division. Pending retirements coupled with a slight expansion of the T/O should permit these objectives to be accomplished.

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S E C R E T

Recommendation No. 15

That the Office of Personnel:

- a. Review the manpower resources needed by PMCD to carry out its full mission and responsibility and adjust the T/O of PMCD accordingly, .
- b. Develop a rotational plan for professional position classifiers, and
- c. Assign well qualified young personnel officers to the division.

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PTB 11-1047

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71 4/74

9 DEC 1971

Executive Registry

21-3 3617

MEMORANDUM FOR: Executive Director-Comptroller

SUBJECT : Review of Manpower Utilization

REFERENCE : Memo fr ExDir-Compt to DD/S dtd 30 Jul 71, subject: IG Survey of the Office of Personnel

1. This memorandum is in response to the questions raised in referent memorandum (Tab A) and contains two recommendations for your approval; these recommendations are contained in paragraph 8.

2. We, of course, agree completely with the importance of Recommendation No. 15 in the Inspector General's survey (Tab B). It lends strong support to our own objectives for the role of the Position Management and Compensation Division (PMCD) in reviewing manpower utilization in the Agency.

3. Our review of the manpower resources needed by PMCD to carry out its full mission confirms the estimate contained in the subject report. The staff of that Division under current procedures would need to be increased to [REDACTED] in order to fulfill monitoring responsibilities and to conduct position and manpower utilization surveys on a three-year cycle. In the face of current restrictions, however, it has only been possible to increase the ceiling of the Division from [REDACTED]

4. During the past year, approximately 60 percent of the man-hours available in the Division has been used in audits of position and manpower utilization. Although we have accelerated the progress in line with the IG's recommendation, under current procedures we cannot hope to maintain coverage of the entire Agency on a three-year cycle with the staff available. In order to increase coverage, therefore, we have streamlined survey procedures and adopted the use of condensed employee-prepared position descriptions whenever possible. We need the full support and cooperation at all command levels to make these surveys efficient. We believe the productivity of our efforts would be further enhanced by publication of an Agency notice along the lines of the attachment (Tab C).

5. Henceforth, surveys will be scheduled with the heads of Agency components at intervals designed to complete Agency coverage once every three years insofar as is possible with the present staff. In the course of these surveys we shall aim to identify areas of ineffective organization, work duplication, and inappropriate utilization of personnel. The results of these surveys will be reported to the operating components and to the Directorate manpower officials concerned.

GROUP 1  
Excluded from automatic  
downgrading and  
declassification

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6. Hopefully, discussions involving the operating officials, Directorate manpower officers, the Director of Personnel and the Director, PPB will bring about necessary corrective actions. We believe it important that the Deputies understand that they will not necessarily lose positions identified in certain offices as excess to their needs. Such positions generally should be available to meet new or more urgent requirements in the concerned Directorate.

7. At the conclusion of the survey and the follow-on discussions, a report will be provided to the Executive Director-Comptroller for your information or such further action as you may consider necessary.

8. It is recommended that:

a. you approve the issuance of the attached Headquarters Notice (Tab C).

b. you approve in principle the procedures outlined above for improving our monitoring and auditing of personnel utilization in the Agency. 25X1A

25X1A  
[Redacted]  
Charles A. Briggs  
Director

Planning, Programming and Budgeting

[Redacted]  
Harry B. Fisher  
Director of Personnel

Atts: 3

The recommendations contained in paragraph 8 are approved.

25X1A  
[Redacted]  
L. K. White

Executive Director-Comptroller

22 Dec 71  
Date.

Distribution:

- Orig - Return to D/Pers
- 1 - ExDir-Compt
- 1 - ER
- 1 - DD/S
- 2 - RCB via D/Pers
- 1 - D/PPB
- 1 - D/Pers
- 1 - C/PMCD via DD/Pers/P&C (w/held)

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C-O-N-F-I-D-E-N-T-I-A-L

25X1A

This Notice Expires 1 September 1972

PERSONNEL

7 January 1972

POSITION SURVEY PROGRAM

REFERENCE: [REDACTED]

1. The referent regulation establishes the objectives of position evaluation in the Agency and provides for periodic surveys to ensure the currency of individual position evaluations and of the position structure as a whole. These surveys are especially important in this time of limited personnel resources.
2. The Director of Personnel is directed to schedule and conduct position and manpower utilization surveys in all components with the objective of achieving complete coverage of the Agency each three years. He will report the results of such surveys promptly to the operating heads and directorate manpower officials concerned. Copies of all reports will also be submitted to the Executive Director-Comptroller.
3. These surveys offer real assistance in our efforts to achieve the most productive utilization of our personnel resources. Full cooperation is essential at all management levels in order that the maximum benefit may be derived from this program.

FOR THE DIRECTOR OF CENTRAL INTELLIGENCE:

JOHN W. COFFEY  
Deputy Director  
for Support

DISTRIBUTION: AB



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73-441511

5 October 1972

MEMORANDUM FOR: Inspector General  
Director of Personnel

SUBJECT : PMCD Surveys

1. I have reviewed the PMCD surveys of CA Staff, ISD, and FI Staff. I understand the degree to which adjustment to strength reductions delayed the resolution of the various recommendations contained in these three surveys.
2. It is quite obvious that the PMCD survey is a useful exercise, applying the expertise of the PMCD to the way in which our grade levels appear on paper and appear in fact. I am pleased at the general high-level acceptance of recommendations (I note without great surprise that there is a higher degree of acceptance in recommendations for upgrading than downgrading), and I think the results should lead to greater efficiency.
3. At the same time, I have the uneasy feeling that this effort does not produce its full potential. It requires a considerable investment from PMCD and also, in terms of the disruptions caused by the interviews conducted there, from the offices being surveyed. PMCD's conclusions are, of course, basically recommendations to the line management of the unit being surveyed and its Deputy Director, with a limited capability of review at the Executive Director level. In this situation, the theoretical and even perhaps quite correct recommendations of PMCD may have to yield to factors in the real world involving the personalities involved, informal responsibilities, etc.
4. It seems to me that the effort might have more value if it were coordinated more closely with IG surveys. Obviously, a PMCD survey takes considerable time and effort, and we can only do a few each year. It would seem quite easy to ensure that these surveys take place at the

CLASSIFIED BY Sign  
EXEMPT FROM GENERAL DECLASSIFICATION  
SCHEDULE OF E. O. 11652, EXEMPTION CATEGORY:  
§ 551.102 (1) - (1) (which one or more)  
AUTOMATICALLY DECLASSIFIED ON  
INDEFINITE  
(option: insert date or event)

**CONFIDENTIAL**

- 2 -

same time and in coordination with IG surveys, the results being incorporated as an annex to the IG survey or being submitted simultaneously. This would presumably reduce the disruption caused by a double set of interviews and at the same time add the Personnel expertise to the IG review.

5. Could you consult on this question and give me your comments.

W. E. Colby

W. E. Colby

Executive Director-Comptroller

Attachments (w/IG copy only):

PMCD Surveys of CA Staff, ISD, and FI Staff

cc: DD/S

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DD/S 22-3961

16 OCT 1972

## Executive Registry

72-4416/2

REFERENCE : Executive Director-Comptroller's  
5 October 1972 Memorandum,  
same subject

1. The undersigned have discussed a more closely coordinated approach to the surveys undertaken by their respective staffs and the advantages and disadvantages of conducting these surveys simultaneously.
2. At first glance, it might appear that combining the PMCD and IG survey schedules would be beneficial and would be less disrupting to the operating component under survey. There is no question but that certain aspects of the PMCD survey interests regarding proper and effective utilization of Agency manpower and skills also coincide with the IG survey interests in this area.
3. However, there is a degree of difference in the general thrust of each other's efforts. Because of this difference, there is, we think, a strong possibility that disruptions within the surveyed component could be increased by a formalized, combined PMCD/IG survey effort. The primary thrust of PMCD efforts is directed at organizational structures, position allocations, and grade levels as matched against the missions and functions of the operating component, with a concern for the component's utilization of its allocated manpower within this particularized frame of reference. PMCD interviews with supervisors and working level personnel are designed to develop objective data that will serve the component's management in the decision-making process.

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4. In this regard, the Inspector General has reviewed the PMCD Surveys recently conducted of the Far East, Western Hemisphere, and Near East Divisions. In addition, the IG discussed the outcome of the PMCD Survey of the WH Division with its Executive Officer, [REDACTED]. Those IG inspectors who surveyed the FE area reviewed the FE Division PMCD Survey. The overriding consensus is that the Surveys were thorough, professionally done, and provided a real contribution to component managers. [REDACTED] cited a number of situations where the PMCD study brought to the attention of division management instances of improper slotting and assignments which were susceptible to correction. The reviews of the PMCD Surveys by the Inspector General and his inspectors indicate that while there is a similarity between the results of the PMCD Surveys and the Inspector General's surveys, there is no redundancy.

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5. The Inspector General's approach to surveys is a substantive one. The inspectors look at component programs and their implementation, judging whether a station is doing the things that it should do, or doing things it should not do, and how well it is doing what it does. There is an interest in the intensity of the effort expended and the work patterns of individuals. Consideration is also given to individual morale, employee needs, and interpersonal relationships. Obviously, all of this involves the IG team in testing the organizational arrangements of a station and the quality of its officers. This, in turn, may well call for a concentration on the matching of personal qualifications with tasks and work load. It is, therefore, inevitable that the IG team will see some of the same things that the PMCD team does and reach some of the same conclusions.

6. There is the question of timing to be taken into account. The PMCD survey schedule is frequently adjusted with little or no advance notice in order to accommodate the establishment of new organizations such as NOCAD, NOCOG, and ICS. In addition, PMCD, in order to meet their requirement of a full cycle of Agency component surveys every three years, schedules a greater number of surveys than does the Inspector General; and the nature of the PMCD survey permits its accomplishment in a much shorter time frame than is required for the IG survey.

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7. The effectiveness of PMCD and IG surveys depends not only on the professionalism and the objectivity of the work done, but also upon the time limits on actions taken in response to survey recommendations. It would be unfortunate if in the combination of PMCD and IG surveys final actions on one study were withheld pending resolution of all of the issues raised in the other. Despite the similarity of objectives and, to some extent, the nature of the inquiries in the respective surveys, the nature of the findings and recommendations are sufficiently dissimilar to warrant the independent presentation and solution of issues as soon as possible.

8. Our review of past surveys indicates that they have obviously been conducted quite independently of each other and with an insufficient degree of coordination. This is wrong. We believe there is considerable affinity between the two and that they can supplement each other.

9. With the above in mind, we have reached the conclusion that both teams operating in a component at the same time would result in the equivalent of two separate surveys being conducted simultaneously. This would be too disruptive, especially in overseas stations and bases. Close coordination, however, is a must and we recommend the following action:

a. that separate but coordinated schedules be arranged for the PMCD and IG surveys on an annual basis with close collaboration to ensure that both units are covering the same areas during an appropriate time frame;

b. that prior to launching a given survey the respective PMCD and IG teams exchange pertinent prior survey report data of the most recent survey conducted in the area by either; and

c. that during the conduct of the survey each team be alert for problems of significant interest to

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the other for appropriate referral and attention in the course of forthcoming surveys.

(Signed) William V. Broe\*

William V. Broe  
Inspector General

/s/ Harry B. Fisher  
Harry B. Fisher  
Director of Personnel

The recommended action contained in paragraph 9 is approved.

/s/ W. E. Colby

26 OCT 1972

Executive Director-Comptroller

Date

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